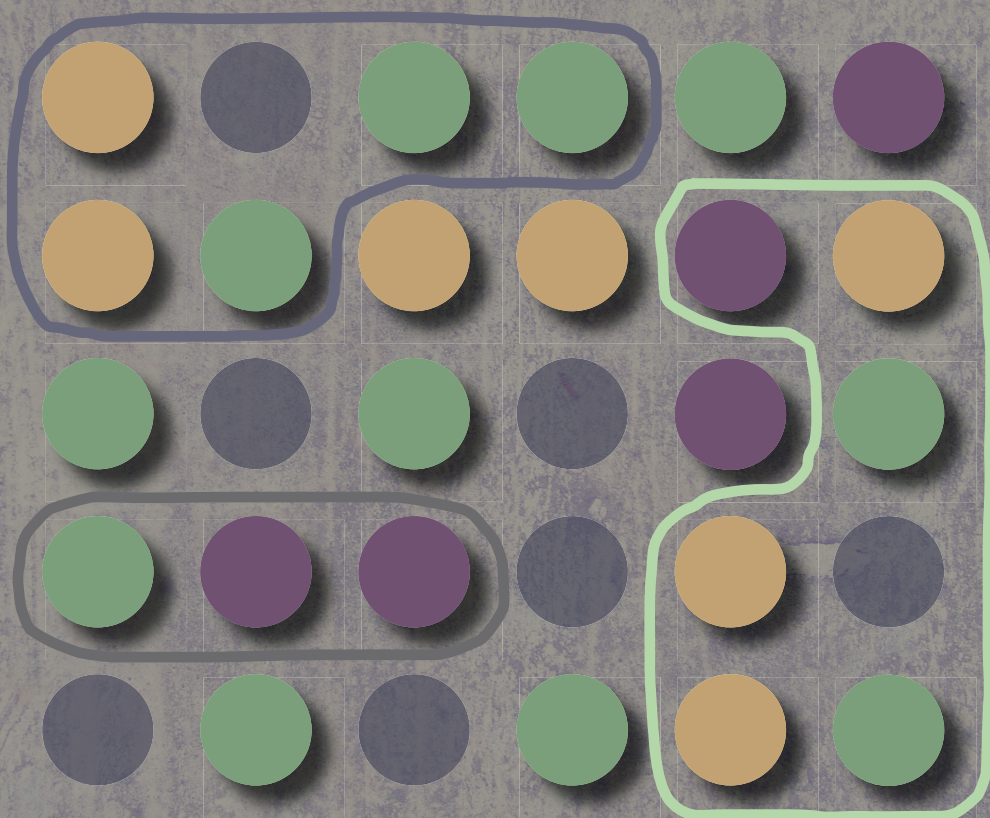


Politics and Policies in Post-communist Transition

Primary and Secondary
Privatisation in Central Europe
and the Former Soviet Union



Soós Károly Attila

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**Primary and Secondary Privatisation in
Central Europe and the Former Soviet Union**

Károly Attila Soós



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Foreword and overview

During the last wave of nationalisation, in 1949, when I was five years old, Hungary's communist government confiscated my father's company (a small factory, with some 30 employees). This was the first significant socio-economic event of which I understood something. That last wave of nationalisations (i.e., confiscations) was followed four decades later by the first post-communist privatisations in my country (and another one to four years later in other former communist countries). Already an economist, with numerous publications behind me, and soon the main speech-maker on economic issues for the second largest political party in the Hungarian Parliament, I certainly understood privatisation better than nationalisation at that time. But understanding required intellectual effort, because the comprehensive privatisation of a country's economy was much more complicated than the comprehensive nationalisation had been. In the 1990s, it was often said that nationalisation was like taking the contents of an aquarium and making fish soup, while privatisation was exactly the opposite endeavour.

In communist nationalisation, economic considerations played little, if any, role. In the case of my father's factory, it should have been obvious that such a small production unit could not really function as a state-owned entity. Nationalisation doomed it; it was closed down soon afterwards (in a town suffering from high unemployment). Communist ideology and political considerations (the latter meaning the elimination of the capitalist class) alone determined the overall blueprint, as well as most practical details, of communist nationalisation.

Post-communist privatisation has been different. The collapse of communism came about in an economic crisis and led to democracy and freedom—at least to far more democracy and freedom than people in European communist countries had had for decades. Under such circumstances, governments could not put aside economic considerations in shaping and implementing their policies (on privatisation or anything

else). Yet in most countries, economic considerations only became predominant in a later phase of privatisation, in the late 1990s and in the 2000s. In this later phase, it was often banks, insurance companies and natural monopolies (electric-energy-distribution companies, motorways and the like) that were privatised. The size, the importance and the (seemingly) guaranteed profitability of these companies obliged governments to place considerable importance on the economic aspects of their privatisation. The consequence was the emergence and increasing role of privatisation methods usually applied in Western market economies: sales to strategic investors, international tenders, IPOs and the like. With this development, the wide variety of creative privatisation methods applied in former communist countries ended.

The analysis in this book does not extend to that (in most countries still unfinished) phase of the privatisation process. This book's focus is restricted to the earlier phase, in which banks, natural monopolies and other such entities prized by governments for the purposes of economic strategy were not subject to privatisation in most countries. The choice of privatisation methods was determined primarily by ideology and politics, somewhat similarly to the previous history of communist nationalisation, even though in some countries (primarily in Hungary) it was influenced more by economic considerations. Of course, this time the ideology was free market ideology. (In Europe, we call this ideology liberalism. The words "liberal" and "liberalism" will always be used in this book with this meaning, not in the more or less opposite sense as accepted in the United States.) And politics was democratic politics this time—certainly much more democratic than the politics were during communist nationalisation.

This book discusses the policies, practices and outcomes of privatisation in six former communist countries, paying particular attention to differences among countries in these fields and to interrelations between the processes of privatisation and the political transition from communism to a new system. The countries are the Czech Republic, Hungary, Poland, Russia, Slovenia and Ukraine.

The analysis is restricted to the privatisation of medium-sized and large enterprises, and only adjunctively deals with the privatisation of banks, non-bank financial companies and natural monopolies (even if such privatisations were already carried out in the period analysed). Nor will the book deal with the privatisation of agricultural entities.

At the same time, our subject also extends beyond the field usually examined under the title of privatisation or privatisation *stricto sensu*. The

latter, of course, means the transfer of the ownership of firms from governmental bodies to private persons or organisations. In this book, this is referred to as primary privatisation. And the analysis will extend to secondary privatisation, here meaning the increasing concentration in ownership structures after primary privatisation.

Secondary privatisation stemmed precisely from the above-mentioned diversity of creative privatisation methods applied in the former communist countries. Namely, in most of these countries, privatisation consisted largely of the distribution of property rights of companies free of charge or very cheaply among favoured (large) groups of the population. The beneficiaries of this primary distribution were generally not interested in retaining ownership: they wanted to sell it. Their selling opportunities varied from country to country, as did the structure of the demand side (e.g., foreign or domestic strategic investors) and other characteristics of the secondary privatisation. And this also depended on government policies and, in turn, on politics.

In one country, Hungary, secondary privatisation was, if not negligible, a lot less significant than elsewhere in the former communist countries of Europe. The reason is that in Hungary, sales for cash to strategic investors (or on the stock exchange) were the basic engine of privatisation. In other words, firms were purchased mostly by (largely foreign) investors who usually wanted to keep them. In the other former communist countries of Europe (not only the five analysed here), the sale of firms at stock exchanges or in the framework of auctions or tenders had a more modest role, and the transfer of their ownership to favoured groups (almost) free of charge was more frequent. The two main forms of this kind of preferential privatisation were the distribution of the ownership rights of enterprises via vouchers to the citizens of the given country (often called “mass privatisation” in the literature) and the transfer of these rights to managers and non-managerial employees of the firms (i.e., to insiders), respectively. The direct result of these kinds of privatisation to favoured groups was fairly dispersed ownership structures.

Under different circumstances, many of the beneficiaries might have retained ownership. In the given countries, however, they usually tried to get rid of their stakes as soon as possible. This was partly because of the population’s consumerist mentality and partly because those concerned understood that the protection of their rights as (small) investors was extremely weak. According to various economic-legal analyses of this issue, a highly concentrated ownership structure corresponds to a low level of investor protection. And indeed, primary privatisation was followed by a

concentration process, i.e., by a secondary privatisation entailing more concentrated ownership.

Even in Hungary, where ownership concentration was already high on the basis of primary privatisation, secondary privatisation enhanced it. In Poland and the Czech Republic, where primary privatisation generated dispersed ownership, secondary privatisation entailed strong concentration. And progress towards concentration was also observed in Slovenia, Russia and Ukraine, but it was significantly slower than in Poland and the Czech Republic. This difference resulted partly because in the Czech Republic, and also to some extent in Poland, property was distributed to all citizens, with the voucher method, and the ownership structure born in this kind of preferential privatisation tended to melt as fast as snow in spring. By comparison—as will be seen later in this study—the structure created by primary privatisation to insiders, which dominated in Slovenia, Russia and Ukraine, tended to be more stable. However, in Poland, where some of primary privatisation followed the insider principle, even this, by its nature more stable, ownership did not prove durable. Thus the slow pace of secondary privatisation in Slovenia, Russia and Ukraine cannot have stemmed only from the more durable nature of the ownership structure established by the mostly insider primary privatisation in these countries.

In Slovenia, Russia and Ukraine the circumstances frightened buyers (domestic and foreign non-insider investors) away from purchasing the ownership titles of the companies from the insiders favoured in the primary, preferential privatisation. It is easy to understand investors steering clear of Russia and Ukraine because of well-known problems with government: corruption, excessive regulation and the like (e.g., van Zon describes Ukrainian bureaucracy as “parasitary”, as opposed to Polish “facilitative” bureaucracy [van Zon 1999]). What seems surprising is Slovenia’s case. This country is rather Western in its level of economic development, in its values and in its general culture, even more so than the four other westernmost (and culturally, most Western) former communist countries, members of the Visegrád group: Hungary, Slovakia, the Czech Republic and Poland.¹ (For example, Slovenia’s ranking according to the Corruption Perception Index of Transparency International is 26, much

¹ The Visegrád Four or V4 group was established in 1991 (before Czechoslovakia split into the Czech Republic and Slovakia) as the Visegrád Triangle, for the purposes of cooperation and furthering their European integration. Cooperation within the group has always been rather loose, but mentioning its name expresses symbolically the general cultural closeness these Central European countries have to one another.

better than that of the Czech Republic—45—or of Hungary, Slovakia or Poland—47, 52 and 58, respectively).² It is strange to find Slovenia at the other end of the spectrum from (three of the four) Visegrád countries, and together with Ukraine and Russia. The latter two countries' rankings in the Corruption Perception Index are 134 and 147, respectively, far behind not only Slovenia but also the Visegrád countries. And more generally, Russia and Ukraine, with the heritage of a “full-blown Soviet-style command economy” (Dean 2000, p. 100), began their transitions to democracy, freedom and a market economy from very bad positions, if not the worst, as opposed to Slovenia, the westernmost republic of former Yugoslavia, which started from one of the best positions. The explanation for this “Slovenian surprise” can be found in the particularities of the political transition towards a more democratic system.

Communist dictatorship in the three Visegrád countries ended with the electoral victories of anticommunist parties. With this break, with anticommunist governments coming to power, the network of informal political relationships between enterprises and the (communist) party-state machinery broke down irreparably. The traditional interpenetration between the state and companies, on which the operation of the communist economy had been based, ended with this break. It ended if enterprise managers were replaced and also if they kept their positions—and of course, at least initially, the latter was more frequent.

This radical change—let us label it hard transition—had important effects both on primary and secondary privatisation. Privatisation to insiders was obviously advantageous for incumbent managers. They were considered by the new governments to be members of the former communist *nomenklatura*;³ consequently, privatisation did not have to serve their

² The Corruption Perception Index (CPI) ranks countries in terms of the degree to which corruption is perceived to exist among public officials and politicians. It is a composite index, a poll of polls, drawing on corruption-related data from expert and business surveys carried out by a variety of independent and reputable institutions. The CPI reflects views from around the world, including those of experts living in the countries evaluated. The Index is regularly published on Transparency International's web page (www.transparency.org).

³ The word *nomenklatura* referred to all those in ruling positions in the party and government machinery in the former Soviet Union and its satellite states in Central and Eastern Europe. Its original meaning was “list”, referring to lists of positions that could only be held by persons approved for those positions by some committee, secretariat, etc. of the communist party. For example, in Hungary, a small country, the positions of CEOs of the largest companies were on the nomenclature of the Political Bureau (the actual control-

interests. Thus insider privatisation was practically non-existent in the Czech Republic and in Hungary. And it played only a limited role in Poland, despite strong trade union demands. (It is important to remember that the new Polish government had its roots in the “Solidarność” anti-communist trade union confederation.)

In Hungary, privatisation was based mainly on pragmatic considerations; the government sought budget revenue from it (and investments into the firms by the new owners). This is why, aside from the rather limited use of insider privatisation, sales for cash were the predominant method of privatisation. In the Czech Republic (before 1993, in Czechoslovakia) and in Poland, the basis of privatisation was the firm conservative (neoliberal) commitment of economic policy makers. Their preferred way (and as they hoped, the quickest way) of (primary) privatisation was to freely distribute ownership of the firms among the whole population (“mass privatisation”). This idea was also supported by important Western expert groups. And it was implemented with few compromises in the Czech Republic, but with many more compromises in Poland. The basic reason for the latter was the support given to insider privatisation by the Solidarność trade union. (Of course, with insider privatisation Solidarność wanted to promote the interests of workers, rather than those of communist *nomenklatura* managers.)

In Ukraine and Slovenia, unlike in the Visegrád countries, political transition came about without any break—with former communist leaders continuing to play key roles in the leadership. We can label this soft transition. Of course, the external break, i.e., the independence won from the federal centre, played a role in keeping internal “peace”. (This was crystal-clear in Slovenia’s cutting ties with Belgrade but somewhat more ambiguous in Ukraine’s case, where the significant ethnic-Russian population was less happy with the breakaway from Moscow.) In Russia, a radical break with the past was attempted, but it was restricted to a short period and to the national government, with only a limited effect on the regions (officially called “subjects of the federation”: republics, oblasts, krais, etc) and even on the national Parliament. In these three countries, where there was essentially a continuous i. e., soft political transition, the network of political relations between enterprise managers and the governing political elite was preserved. Instead of the adversarial, legalistic relationship that exists between government and business in Western

ling body) of the communist party; managers of medium-sized companies depended on county- or city-level party committees, and so on.

countries, a kind of uninhibited closeness between the business and government elites, a cosy collaborative relationship, remained from the communist system. Under such conditions, the domination of insider privatisation, which gave managers the biggest advantages, was almost self-evident.

The continuity in the Russian, Ukrainian and Slovenian political transitions explains the slow pace of secondary privatisation, too. It explains the fact that, in these countries, potential external (including foreign) buyers were frightened away. The relationship between firms and government changed little with (insider) privatisation. This explains the governments' behaviour, both in their role of (partial) owners of the firms and in how they carried out their general administrative tasks.

Governments remained partial owners of many firms after the first steps of privatisation, not just in Russia, Ukraine and Slovenia but in all European former communist countries. However, they kept and exercised their rights in different ways. In these three countries, even as minority owners, governments behaved in a way that caused their co-owners grave uncertainty. On the other hand, governments in these countries exploited their administrative power for the informal, unpredictable "taxation" of the firms. Firms were often organised into special "networks", in which bad ones had to be financed by good ones—this involved the informal taxation of the latter. In Russia and Ukraine, the high level of corruption was a supplementary element of informal taxation. The subsidising (soft budget constraint) of economically weak firms—which was a widespread practice in the Czech Republic and also far from unknown in Hungary and Poland—was not the essential point of the phenomenon discussed here. The essential point was the fact that the source of the subsidies in question was the informal, unpredictable "taxation" of other, good (profitable) enterprises. This practice frightened away potential external (including foreign) owners.

In the first years of the 21st century, the ownership concentration of privatised firms in the Czech Republic and Poland reached or exceeded Western European "norms" (and in Hungary this was achieved even earlier). In other words, secondary privatisation in the Visegrád countries was completed. And, as mentioned above, preferential (primary) privatisation ended some years earlier. Thus new dispersed ownership that would potentially be subject to further waves of secondary privatisation was not being created. This analysis stops there and does not follow the continuing secondary privatisation in Russia, Ukraine and Slovenia after 2002.

However, at the end of the book we cannot avoid addressing the question: which way was better? Which strategy provided better results? The comparison omits Russia and Ukraine, since their starting conditions were too different from those of the other countries. Four countries remain. On the one hand is Slovenia, with its slow reforms and continual search for consensual solutions. On the other hand are the three Visegrád countries—the Czech Republic, Hungary and Poland—which were more radical and courageous not only in privatisation, but also more generally in reforms aimed at transforming the system inherited from communism into a market economy. In economic development, the three radical reformers seem to have been somewhat more successful. However, the picture is complicated by two crucial factors. First, policies followed in the different countries also had an impact on social development, and in the latter Slovenia performed better than the Visegrád countries. Second, not only privatisation and other systemic transformation policies but also macroeconomic policies differed from country to country. The latter influenced each country's successes and failures. And furthermore, systemic transformation policies and macroeconomic policies cannot be treated independently of each other.

1

Introduction

1.1 The background

This book is not intended as a comprehensive study of privatisation in all former communist countries from the late 1980s to the present. It analyses only the typical paths and fundamental methods of privatisation. For this book's purposes, the examples of some countries are sufficient. Six have been selected: the Czech Republic, Hungary, Poland, Russia, Slovenia and Ukraine. The reader will see the diversity of privatisation methods applied in them. That diversity cannot be increased by adding further countries to the sample. This suggests that the sample will serve our purposes. The selection was certainly influenced by the author's familiarity with the countries selected. But besides that, it seemed best to include cases in the sample that were extreme or, at least, clear-cut. The latter consideration alone would justify the inclusion of Hungary (even if it were not the author's home country) as an example of mostly privatisation for cash to strategic investors, and also that of the Czech Republic as the model of privatisation by free distribution to citizens ("mass privatisation"). From among the rather extreme cases of insider privatisation, Russia, Slovenia or Ukraine—any one of the three—would have worked. Thus all three together have clearly been selected for a different reason, as well as Poland, in which one sees a balanced mixture of different kinds of privatisation, rather than anything extreme.

Russia, Poland and Ukraine were selected in part for their sizes. They are the largest former communist countries in Europe, both in economic size (gross domestic product or GDP) and population. Larger country size tends to entail both more interest from readers and better availability of relevant data. However, size was certainly not a reason for including Slovenia, a tiny country, among the countries under study.

Table 1.1.1 Per capita GDP (at purchasing power parities) of European former communist countries, USA=100 (2007 data)

Country	GDP per capita	Country	GDP per capita
Slovenia	59,2	Belarus	23,7
Czech Rep.	52,1	Serbia	22,7
Estonia	46,1	Montenegro	22,3
Slovakia	44,5	Macedonia	18,7
Hungary	41,5	Azerbaijan	16,3
Lithuania	38,6	Bosnia and H.	16,3
Latvia	38,3	Ukraine	15,1
Poland	35,6	Albania	13,9
Croatia	33,9	Armenia	12,5
Russia	32,2	Georgia	10,2
Romania	24,9	Moldova	5,6
Bulgaria	24,7		

Source: the World Bank's World Development Indicators database

Among all these countries, Slovenia has the longest history as a Western country: it was part of the Habsburg Empire from the 14th century to 1918 (when it became part of Yugoslavia). The Czech lands (today the Czech Republic) followed it in the 16th century, and the majority of Hungary, which was under Turkish occupation until the end of the 17th century, came even later. (After World War I, with the collapse of the Habsburg Empire, Hungary became a separate country; the Czech lands, merged with Slovakia, became another one, called Czechoslovakia.) Poland was partly under Western (Prussian and Austrian) rule and partly under eastern (Russian) rule during the last centuries of its stormy history (it regained its independence in 1918).

Slovenia is economically the most developed European former communist country, but a close-to-Western level of economic development (in GDP per capita) can be observed in all these countries (and also in the Baltic countries: Estonia, Latvia and Lithuania) (see Table 1.1.1). And many researchers have found that many of the economic, legal and other traditions born in those times even survived the communist period.¹

All of these countries experienced life under the communist economic system. From the enormous literature presenting this system's general

¹ For instance, Berglöf and Pajuste (2005) mention the role played by "earlier legal traditions" in shaping the system of corporate governance in former communist countries during the 1990s.

features, the most noteworthy are a rather old book, *The Political Economy of Communism* by P. Wiles (1962), and a rather new one, *The Socialist System* by J. Kornai (1992). But, without describing the general features of the communist system, it is important to remember that the legacy of communism was different in different countries. Communism lasted seven decades (1919–1990) in the Soviet Union, i.e. in Russia and in (the vast majority of) Ukraine, but only about four decades in the other countries (1946–1989 in Slovenia, 1948–1989 in the three Visegrád countries). To demonstrate the importance of this difference, consider the issue of confiscated (nationalised) properties. This was an unavoidable issue everywhere in Central Europe, and after lengthy debates and preparatory work, reparation or at least partial compensation was carried out in those countries. On the other hand, in Russia or Ukraine the issue was never seriously raised. Of course, factors other than the length of the communist era also contributed to this difference. In the Russian Empire, there was no tradition of private ownership of land before the 1917 communist takeover. Furthermore, members of the former propertied classes, whose descendants could have received compensation for the confiscated properties, were largely annihilated physically in the Stalinist period.

The Soviet Union was also more closed; thus, compared to Central Europe, social, political and economic life was less exposed to Western influence. Besides the “iron curtain” separating the free peoples of Western Europe from the oppressed peoples of the Soviet Union and its satellites, first described by Winston Churchill in his famous Fulton speech in 1945 (e.g., Gilbert 2002), there was another, as the late historian Isaac Deutscher used to say, even thicker and higher “iron curtain” between the Soviet Union and the satellites.

The satellites (as communist countries) appeared after World War II, and at the start all of them seemed to be competing to be the most similar to the Soviet Union. But then their actual socioeconomic systems gradually diverged. The emergence of “national communisms” began in 1948 with the “excommunication” of the People’s Federal Republic of Yugoslavia. This country’s “ultrastalinist” (Bideleux and Jeffries 1998, pp. 555–556) heresy, with the revolutionary zeal of its leaders causing trouble to the Soviet dictator Stalin in his attempts at making deals with the Western allies,² which was the actual cause of the excommunication, did not

² Indeed, this Stalin–Tito conflict began earlier, certainly not later than 1943 (Glenny [1999], pp. 529–30) when, after its dismemberment, the new, communist Yugoslavia was not still established, and Tito headed a partisan army. Yet the conflict became open only

last long after the break. In 1950 the country's leadership accepted the yielding of partial control over enterprises to workers' councils and in the following years even accepted a limited role of market forces in the communist command economy. Later, in the 1960s, market mechanisms took on a more important role in the Yugoslav economy. At the peak of liberal reforms in 1965–1966, Yugoslavia was already far from a full-fledged communist command economy. To be sure, it was also far from a usual capitalist system, because its labour and, in particular (given that private property was extremely restricted), its capital markets were highly distorted. (For more information on Yugoslavia's market-planned system, see Dubey [1975], Horvat [1982], Milenkovich [1971] and Pejovich [1966]). This reform tide was followed by an ebb from 1968 on. Political control over economic processes was consolidated, but the planned economy was not restored. From 1970 on, nationalism in the country's constituent republics strengthened, and after the death of Josip Broz Tito, the founder of communist Yugoslavia, in 1980, it slowly undermined the unity of the communist party. This led to political, then military conflicts between the republics and the disintegration of the federal state, resulting in the birth of new countries, including Slovenia.

The second country to choose the path of “national communism” was Poland, after 1956. This development resulted from a general thaw in the communist camp following Stalin's death in 1953. In Poland's case, dramatic conflict with the Soviet Union was avoided, but so was radical reform. Religious and cultural freedom increased significantly, but the communist party kept its political monopoly. In these respects, the Polish system was not too different from the Yugoslav one. Also, *kolkhozes*—formally “cooperative” institutions working on the basis of the collective will of their members, but actually state-controlled institutions that peasants were forced to join (with their land, horses, carts, and so on)—were disbanded early, in the 1950s in both countries (but they remained in place until the end of communism everywhere else). At the same time Poland, unlike Yugoslavia, took part in the Soviet-controlled military and economic cooperation of European communist countries (within the Warsaw Pact and the Council of Mutual Economic Assistance [CMEA], respectively). And in Poland no significant economic reform was introduced

in 1948 when, with the unfolding of the cold war and the rapid removal of the remaining democratic and liberal scenery in the Central European Soviet “sphere of influence”, Yugoslav ultrastalinism ceased to be a real bother for Stalin. This timing was rather paradoxical.

before the early 1980s. Then the economic reform followed a kind of peaceful revolution, a strike movement from which the *Solidarność* trade union—actually an opposition party—was born, and a less peaceful counter-revolution, the temporary introduction of military rule and the banning of *Solidarność*.

Hungary began to build its version of “national communism” in the early 1960s, after the 1956 anticommunist revolution and the ferocious reprisal. A limited economic reform (the “New Economic Mechanism” of 1968) introduced market economy elements into central planning, with some success. Thereafter, Hungary’s system was dubbed “goulash communism” in the West. Of course, the communist party’s political monopoly remained untouched in Hungary, too, and even the economic reform was held back after 1968 (and revived somewhat in the 1980s).

In Central Europe, the rigid Soviet-type economic system and the Soviet-type lack of all kinds of civil freedom was maintained only in Czechoslovakia. The rather radical political and economic reforms attempted there (known in the West as “the Prague Spring”) were abrogated after the armies of Warsaw Pact “allies” invaded the country in August 1968. (This invasion was an anti-reform turning point in the communist part of Europe, and also partly explained the halt of Hungarian reforms.)

A fundamental feature of European communist regimes was the severe restriction of private ownership. Families could own their apartments or houses, weekend houses, cars, and so on, but for this (at least a little uncommunist) phenomenon a new concept—personal, rather than private, property—was invented by official ideology. Private entrepreneurship was placed under strict limitations. Private employment of other people for commercial purposes was illegal in all the countries under study here. Within that general framework, in Hungary, Poland and Yugoslavia (as well as in most other European communist countries), private commercial activity was allowed, but of course, it could only be based on the work of family members. And private activity could not be organised in corporate forms, meaning that the liability of private entrepreneurs was always unlimited.

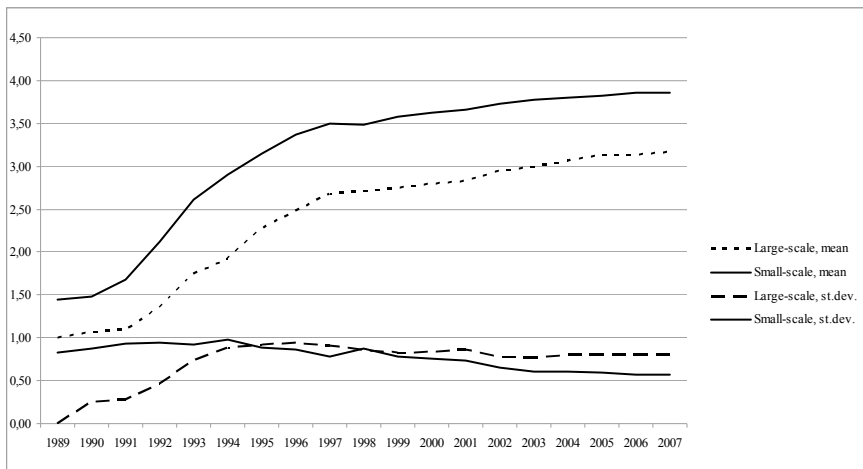
In the Soviet Union and Czechoslovakia, the regime was tougher: any private commercial activity was illegal, except for certain kinds of services (house cleaning, baby sitting and the like).

Thus, in the late 1980s and early 1990s, when the transition from communism to (some kind of) capitalism began, privatisation seemed like an enormous task. And privatisation indeed has been (and in quite a few countries will remain) an enormous task. But, as mentioned, this analysis will only cover a part of it.

1.2 (Another) delimitation of the subject

Besides focusing on only six countries, examining only the 1990s and the early 2000s, and omitting the privatisation of banks, insurance companies, natural monopolies and agricultural companies, this study will also not discuss the so-called small-scale privatisation: the auctioning of small shops, restaurants, pubs and other small service or other companies. The explanation for this omission is essentially included in the word “auctioning”, with which we labelled the process, and which reflects the fact that in this specific sector, the privatisation method used was rather uniform from country to country. Thus this sector is not a good terrain for a research of differences among countries. Nor does it offer Western readers much new knowledge. (Auction methods applied in small privatisation were rather simple and well-known ones.)

Graph 1.2.1 Average progress and standard deviation of the progress of small- and large-scale privatisation in 29 former communist countries



Source: own calculations based on data of the European Bank for Reconstruction and Development

Small-scale privatisation was a relatively simple task, and it was implemented fairly quickly in almost all former communist countries. The European Bank for Reconstruction and Development measures progress towards a market economy with “transition indicators” every year in 29

former communist countries.³ Values of the indicators range from 1 to 4.33,⁴ with 1 representing little or no change from a rigid centrally planned economy and 4.33 representing the standards of an industrialised market economy. Small- and large-scale privatisation are measured using separate indicators. Cross-country averages and standard deviations between 1989 and 2007 of both are plotted in Graph 1.2.1. The graph shows that the average value of small-scale privatisation started from 1.5 (showing that some privatisation had already been performed) in 1989 (but actually only Poland and Yugoslavia were above that level in that year) and proceeded relatively quickly. Its cross-country standard deviation began to decrease as early as 1994, meaning that an increasing number of countries had already made important progress in this field. And then, small-scale privatisation was completed, or almost completed, a decade later.

But that does not hold for the subject of this analysis: the privatisation of medium-sized and large companies of industry, building trade, retail and wholesale trade, transportation and other non-financial services that were not natural monopolies was a more difficult and longer lasting process. Unfortunately, it can only be shown here together with the even slower privatisation of natural monopolies, banks, etc., which is also included in “large-scale privatisation”. As the graph shows, the average value of privatisation performance of this kind started from an average level of 1 in 1989, of course with zero standard deviation. This average has always been increasing in parallel with, but lagging behind, small-scale privatisation. And large-scale privatisation’s standard deviation first increased, then fell only slightly with time, demonstrating that important differences among countries persisted.

1.3 Managerial power and the bogey of spontaneous privatisation

The radical transformation of ownership in a country raises a whole series of intriguing questions. If such a transformation becomes the task of economic policy in more than two dozen countries, then the intrigue is even

³ Besides the six countries under study, they are Albania, Armenia, Azerbaijan, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Macedonia, Moldova, Mongolia, Montenegro, Romania, Serbia, Slovakia, Tajikistan, Turkmenistan and Uzbekistan.

⁴ Indicator values displayed in the “Transition Reports” published (e.g., EBRD 2007) are 1, 1+, 2–, 2, 2+, etc.; for the calculations here, they have been converted to 1, 1.33, 1.66, 2, 2.33, etc.

greater. Thus the issues of privatisation in former communist countries have been discussed in countless articles, books and reports. References at the end of this book include only a small fraction of this literature. However, the start and the formation of the ways and means of the process were probably influenced more strongly by the political circumstances than by the intellectual effervescence.

Extreme examples of this “primacy” of politics include two basic elements of the privatisation in Russia. On the one hand (as will be seen below), the main privatisation method applied in Russia from 1992 onwards was a solution that the government accepted (as an amendment of its own proposal) only because otherwise Parliament would not have accepted the privatisation law at all. The reason was that only the amended law corresponded to the interests of enterprise managers who dominated the Parliament. On the other hand, as Dabrowski et al. (2001) underline, the creators of Russian economic policy originally intended in 1991 not to privatise before stabilisation and liberalisation, but nevertheless they did so in 1992. Why? Obviously, they were afraid that the growing unpopularity of the economic reforms could later encumber privatisation (Boycko et al. 1995). But they must have feared stirring up political conflict over “spontaneous privatisation” as well.

Public opinion regarded the complex phenomenon of spontaneous privatisation as simply the theft of state property by enterprise managers. And spontaneous privatisation was rather widespread in Russia (e.g., Radygin 1994, mainly Chapters 3 and 4; Gaydar 1994). Public perception can be characterised by the following event. At a conference in the spring of 1992, the Russian liberal economist Naishul commented on the mass (give-away) privatisation plans of Privatisation Minister Chubais by saying, “Your plans to privatize Russian industry will never work. Everything has already been privatized, and there is nothing left to give away” (Buiter 2000, p. 606).

This evaluation of spontaneous privatisation was highly exaggerated (although not as exaggerated for Russia as for, say, Hungary). But this kind of overreaction to privatisation was a political factor in all the countries studied, and it made the elaboration of privatisation methods and the start of privatisation an urgent task.

Basically, the incumbent enterprise managers, with their strengthening positions, were behind spontaneous privatisation and also behind the talk about it. To understand this, it is important to note that before the beginning of privatisation (and more generally, of transition), the hierarchical power system started to disintegrate, and enterprise autonomy started to strengthen.

In some countries, it was a restart. For example, in Yugoslavia (and thus in Slovenia) workers' self-management of enterprises was established long before the 1980s. However, self-management in Yugoslavia was a rather malleable concept. In the 1960s it meant enterprise autonomy, and reforms aimed at strengthening market forces in the economy, with tendencies of real managerial power over enterprises. After 1968 the country's leadership campaigned against such "technocratic" tendencies, under the flag of the protection of workers' self-management⁵ (what else?). This campaign was the task of the communist party (League of Communists), which had to represent and, not surprisingly, also determine the interests of the workers. But then, in the 1980s, these trends of resurrection of classical communism, of the party-state machinery and the beloved leader at its helm ruling all developments in the society ebbed away again, and enterprise autonomy and market forces started to regain their important role in the economy. This was also expressed by the enterprises' now emphatically being considered "social", rather than state, property. This concept, with its benevolent murkiness, left some role for the state, too. However, the sense of the change was clear: (again) increasing enterprise autonomy and at the same time strengthening the self-management rights of the employees, as opposed to the rights of the local organs of the communist party hierarchy and the party-controlled state organs.

In the other countries, enterprise autonomy and workers' self-management rights had not gone through as many rises and declines—if at all—but now the trends were similar. In Hungary, the suspended reform process of the 1960s was revitalised from the early 1980s on. The original blueprint of the 1960s economic reform included some vague hints at self-management rights of the workers, but with the rather early halt of the reform, this issue disappeared from the agenda. Now, in the 1980s, it was different: parallel with the enhancement of enterprise autonomy, Enterprise Councils were established at medium-sized and large firms. These councils received partial control and supervision rights over the managers.

Developments in Poland were similar: firms became less dependent on government bureaucracy,⁶ and self-management organs were established. And even in the Soviet Union, the new Law on Enterprises (1987) in-

⁵ See Kardelj (1981).

⁶ However, historians, looking back from the late 1990s, rightly characterised Jaruzelski's reforms as "a small dose of much-needed economic liberalisation" (Bideleux and Jeffries 1998, p. 575).

creased enterprise autonomy and conceded important control and supervision rights to “working collectives” and their newly established Enterprise Councils (Frydman et al. 1993).

Among the countries studied in this book, only the Czech Republic (or, at that time, Czechoslovakia) did not experience such changes before 1989 (Gati 1987). But in all the other countries, enhanced enterprise autonomy and some degree of self-management rights came in parallel, and not by chance. In Yugoslavia, the memories still lingered of trends of managerial domination that had appeared with the liberalising reforms of the 1960s. And memories were basically similar in the other countries too. Whenever enterprise autonomy increased, the positions of enterprise managers strengthened.⁷ Of course, this strengthening was always roughly proportional to the increase of autonomy, meaning that, other than in Hungary and Poland, it was rather limited. Now however, all countries of the (disintegrating) communist camp made a serious effort to enhance enterprise autonomy, and thus managerial positions strengthened significantly. In Russia, for example, the situation was popularly perceived as a “managerial revolution” (Clarke 1994). In the previous communist system, the party-state hierarchy could react in two different ways to such trends of increasing managerial power: by either withdrawing the liberalising reforms or introducing (or enhancing) the self-management rights of the workers. Now, at the start of transition towards capitalism, only the latter way was open, and it was chosen in the countries studied.

However, the enhanced self-management rights of enterprise collectives did not yield the expected results. For example, in Poland, where the new legislation formally guaranteed enterprise employees fairly strong self-management rights, trade unions demanded that the government restrain managerial abuses (e.g., Hanley et al. 1998). And spontaneous privatisation was the most evident, and for much of the public the most irri-

⁷ And opportunities for anti-reform political initiatives were often created, also in countries other than Yugoslavia, by the advantages enjoyed by managers. For instance, under the 1968 “New Economic Mechanism” liberal reform in Hungary, all employees of an enterprise had profit-dependent bonuses, but the maximum amount of the bonus was 80 percent of the salary for top managers, 50 percent for middle-level managers and 15 percent for other employees. Furthermore, these proportions between the three groups’ bonuses had to be assured when (as was usual) there was not enough profit to pay the maximum level of bonuses. A political campaign against this “discriminatory treatment of simple workers” carried out by enterprise-level communist party and (of course, party-controlled) trade union organisations and tacitly encouraged by higher levels of the party hierarchy was the first political attack against the New Economic Mechanism (Soós 1987).

tating, manifestation of increased managerial power. It emerged in all European transition countries—in Slovenia (Simoneti et al. 2004) as well as in the Soviet Union (Medova and Tischenko 2006), Hungary (Mihályi 1998) and Poland (Hanley et al. 1998). There were harsh reactions to spontaneous privatisation everywhere. In short, public perception saw in it the stealing of state property both directly through transforming state assets into private ones and indirectly, by creating parallel firms in order to channel corporate profits into them whilst leaving costs and liabilities with the original state-owned enterprise. This meant that spontaneous privatisation would have been an illegal activity, designed to transform public property (enterprises or parts or profits of enterprises) into private property without paying for it. The Hungarian case—the comments and debates of politicians and in the mass media—are described and analysed in detail by Mihályi (1998).

The reality was more complicated. On the one hand, Hill and Karner (1996) state correctly that the communist legal system (which was almost intact when the transition began) was imperfect, with too many loopholes. Thus it was easy to steal without breaking the law.⁸ On the other hand,

⁸ My own research published in the 1980s confirms this analysis. The starting point for me was that the breakdown of national plans into concrete orders for enterprises in a communist planned economy could be characterised by an effort to prescribe enterprise activities in as much detail as possible. Contradictions between different orders given to enterprises and the unforeseen effects of many individual orders were inevitable. (For instance, a furniture factory had to increase its output of tables—the number of tables produced—every year. If it found it hard to get increasing amounts of wood—which was not uncommon—then its interest would have been to produce only small tables. This was an unforeseen effect.) Unforeseen effects and similar absurdities could only be avoided through informal control by the party-state hierarchy. This informal control meant that enterprises were not supposed to execute orders in ways that would cause damage to the national economy. Of course, it was rarely easy to anticipate what would or would not cause damage. (But significant guidance could often be found in the most recent documents of the communist party. For example, if improving the balance of foreign trade was a priority, then it was a good idea to reduce the use of imported materials, even if that resulted in increasing total production costs.) Because of the obvious imperfection of such informal controls, improving the system of planning and controlling enterprise activities by formal orders was a permanent task of the authorities. But with all new solutions new unforeseen effects were created (Soós 1987a). Consequently, informal control could never be abolished under communist planning, not even in its reformed, partly market-regulated Yugoslav or Hungarian versions. However, when transition started, and the control of the communist party over the appointment and removal of enterprise managers first weakened, then disappeared, informal control gradually ceased to exist. With this, a strange vacuum emerged, a lack of rules of behaviour, in which certain forms of

what was labelled spontaneous privatisation was not always privatisation. In the communist system, enterprises were simple economic units subordinated to ministries or lower level government organs (and to party organs). They were not organised in the usual corporate forms of market economies, with boards of directors, supervisory boards and the like. Spontaneous privatisation was often restricted to the transformation of an enterprise or its parts into such corporate form. With this corporatisation, the state remained the owner (though its ownership might become indirect). Nervous politicians and journalists, let alone wider public opinion, largely did not understand the difference between corporatisation and privatisation. On the other side, the Western researcher, for whom this difference was clear, found it problematic that at the beginning of transition in Hungary, spontaneous privatisation resulted in the avoidance of actual privatisation: “(T)he adopted policy of spontaneous privatization has transferred only a small proportion of state assets to genuinely private hands” (Falcke 1996, p. 30).

Móra (1991) and Mihályi (1998) demonstrate, using Hungarian examples, that spontaneous privatisation, besides being only partially privatisation, was also only partially spontaneous. Corporatisations of parts of enterprises—representing the lion’s share of spontaneous privatisation deals—were monitored and partly even controlled by the superior organs (ministries or city councils), and they were partly motivated by (deliberate) incentives: corporatised units were subject to preferential tax treatment (and not only in Hungary). This is not to say that abuses did not happen. In extreme cases, complicated manipulations resulted in enterprise managers’ becoming (usually partial) owners of previously state-owned assets. However, in the first years of transition, enterprise managers did not strive to become owners quickly (e.g., Eyal, Szelényi and Townsley 1997; Bozóki 2003). Common abuses included top managers appointing themselves to long-term, well-paid positions as managers, or on the board of directors. It was also not uncommon for managers of a public firm to establish private companies that then struck advantageous deals with the public firm, a scheme known in Western corporate-governance literature as “self-dealing” (Djankov et al. 2005).

In the end, the reality of spontaneous privatisation was mostly different from the outright stealing of public property. Nevertheless, and even

stealing state property became allowed. As Hill and Karner (1996) stress, this was possible because previously nobody had felt the need to formally forbid this kind of theft. It was so disloyal to the communist party that nobody even thought of doing it.

though more slowly and in less direct ways than public opinion perceived it, spontaneous privatisation was the beginning of the process in which a part of the incumbent elite—economic bureaucrats of the communist system—became new owners. Sociologists analysed this process thoroughly, from various points of view (e.g., Staniszki 1991, Hankiss 1989, Szalai 1993, Bozóki 2003). Chapter 6 will address differences among countries in this respect.

At the same time, governments had to formulate their own privatisation policies and mechanisms as alternatives to spontaneous privatisation, and to the public perception of spontaneous privatisation. These policies and mechanisms will be addressed below.

2

Privatisation: why and how?

Of course, in this discussion of privatisation policies and mechanisms, aside from the political circumstances and pressures of those turbulent times, it is important to note some deeper, partly political but partly economic factors that determined the need for and the method of privatisation.

2.1 The need for privatisation and the irrelevance of long-term considerations

In the early 1990s, the slogan of transition meant a demand for a market economy, political freedom and democracy. The herd of enterprise managers appointed and supervised by the government had been an important pillar of one-party dictatorship. To establish democracy and ensure political freedom, this kind of party-state control over the economy had to end. The situation in which (almost) everybody was a public employee (and thus more or less an employee of the ruling party) had to change. An almost universal belief was that the market economy required private ownership. Previous market economy models built on state property (Barone, Lange, Taylor, Lerner) were almost forgotten in the early 1990s. In the countries under study, they did not have many adherents with serious intellectual or political clout.

Economic arguments against the theory of market socialism based on public property were less important than the theory's lack of adherents—but they are worth noting nonetheless. The starting point of the theory in question is that the state as owner can order enterprise managers to follow the objective function that is usually attributed to private firms (i.e., the maximalisation of shareholder value). However, this is problematic in at

least two respects. First, actual private owners' appetite for risk varies (as Hayek notes); thus we do not know how to fine-tune the appetite for risk of the managers of state-owned firms. In other words, we do not know what the latter has to be similar to. On the other hand, and more generally, a whole series of government failures are relevant here (Megginson and Netter 2001). For example, the government pursues quite a few other objectives besides the maximalisation of shareholder value. Beyond that, objectives change when new governments come, implying that a credible commitment to a particular set of objectives is not possible. This state of affairs restrains the efficiency of public firms.

And the objective set by the government for firms may well be contrary to efficiency or, more generally, to the objective that the government wants to follow. We know this from the experience of the communist economy: the permanent change of stimuli set for enterprise managers stemmed only partly from changing economic or political preferences of the governments. Other changes of stimuli could be explained by the unexpected, dysfunctional wild effects of the previously applied stimuli. This problem can also be formulated by saying that whatever the government's objective is, it is difficult, indeed impossible, to write all-encompassing contracts that connect enterprise managers effectively to that objective. Besides all this, it is also problematic that the government does not, in practice, allow big firms to go into bankruptcy, which weakens economic discipline.

"Technical" components of the problems of state property (its complicated character, and the resulting impossibility of government control over enterprise managers) are analysed, e.g., by Vickers and Yarrow (1990). The more political elements of the economic arguments (the consequences of the politicisation of government control and actions) are treated by Shapiro and Willig (1990) and Shleifer and Vishny (1994, 1996a).

However, neither these economic arguments nor the limited popularity of public property gave any concrete answer to the question of what should be done with public property.

This question can be broken into three subquestions. First, virtually no one thinks that all state-owned enterprises have to be privatised. Where should the limits be? This rather difficult question can be set aside here, as this book's scope does not go beyond fields of the economy whose privatisation, at least in principle, could not be opposed on the basis of usual economic considerations. (For example, the privatisation of natural monopolies, which is not treated in this book, requires complicated systems of regulation. Without the latter, most economists would oppose such

privatisation; but even with regulations in place, the rationality of the privatisation of these companies is debated.¹) The second question is: what kind of ownership model is better? And the third: what is the best path to the selected model, i.e. how should privatisation proceed? The second question concerns basically larger firms. The restriction of the ownership of such firms to individuals (individual families) causes damage (mostly missed investment opportunities), and advanced market economies assure solutions for the collective ownership of (larger) firms.

Two basic solutions (two corporate ownership and governance models) have been found. One is the Anglo-Saxon model of “scattered” ownership, in which all individual shareholders tend to have small shares (meaning at least that nobody has a majority or even a “blocking minority”, which may be set, e.g., at 25 percent of the shares, and which would give its holder the right to prevent certain important decisions). This model is not perfect: it is difficult to organise effective and efficient control of the firm’s executive organs by its shareholders (principal–agent problem). On the other hand, in the more concentrated European (continental) ownership model, big shareholders can usurp the rights of small shareholders—this is in some ways a different situation but also belongs to the principal–agent type of problems. The two models suffer from two somewhat different deficiencies of the capital market, and it is not clear which is more damaging and which can be treated more easily. If the positions of economists publishing on this issue were taken as votes, the Anglo-Saxon dispersed ownership model would probably be the winner, but, for example, according to Roe (1993) the introduction of the continental model would be desirable. International organisations—mainly the Organisation for Economic Cooperation and Development (OECD) and the European Union—are pursuing the convergence of the two models without choosing between them. They strive to develop codes of corporate governance that may help guide countries in applying any ownership model (e.g., Solomon 2004).

For the communist countries, choosing between the two models—difficult in principle—would have been rather easy in the early 1990s. The Anglo-Saxon model would not have been a real possibility for them, either in the short term or in the mid-term (Berglöf and Pajuste 2003). This model, not only theoretically but even in its genuine, imperfect form (which can be observed in Anglo-Saxon countries), requires a refined

¹ See, e.g., Primeaux (1986), Hanke and Walters (1987), California (1995), Mack (1995), Bradburd (1995).

system of the protection of small shareholders' interests that can only be developed slowly, with huge effort. The problem, of course, is not really the lack of legal framework. Laws can be changed relatively fast. The big obstacles to an Anglo-Saxon type corporate ownership structure are getting major participants in the economy to accept the new rules and establishing adequate enforcement mechanisms (e.g., Boubakri et al. 2003).

Thus the choice between the two models would have been easy. However, it was not timely. No choice had to be made, and no choice was made between the Anglo-Saxon and the continental model. For example, mass privatisation to all citizens via vouchers resulted in an extremely dispersed ownership structure. Therefore it might seem similar to the very Anglo-Saxon privatisations implemented in the 1980s by Margaret Thatcher in Great Britain. But it never involved the choice of that model, even in the Czech Republic, where this privatisation method was applied on the largest scale. Even the slogan of the Czech (before the 1993 split of Czechoslovakia, the Czechoslovak) privatisation—privatisation for privatisation—was partly intended to reject any decision about selecting a particular ownership model. Furthermore, Minister of Finance (later Prime Minister) Klaus, who treated mass privatisation as one of his most important tasks, explicitly recognised the transitory character of this solution:

“The state does not know how to find effective ownership structures nor owners. Privatisation is therefore no more than a first step to finding an effective ownership structure and certainly not the last step.”²

It would also be useless to look for a vision of the desired future ownership structure, for instance, in the programme of the Hungarian government established after the free parliamentary election of 1990 (A nemzeti 1990), or in the laws approved by Russia's parliament in 1991 (or in the official explanations of these laws).

As for the third question, the one concerning the ways and means of privatisation, it could not be avoided, but answering it was very difficult.

2.2 The limited applicability of the classical solution

Shleifer and Treisman's book (2000) on Russian economic reforms was titled *Without a Map*. With this title, the authors sought to stress that, at the start of transition, there was hardly any practical experience to rely on in preparing and implementing the reforms of the transition process. Lim-

² *Ekonom* 19/1997, quoted by McMaster (2001).

iting this general issue here to the main dilemmas related to privatisation, it is worth examining the sequencing and timing of the reforms: should macroeconomic stabilisation, liberalisation or privatisation have been the first task, or did all the three have to be implemented simultaneously, and how fast? Besides that, to what extent was privatisation (and the financing of privatised firms' activities) possible with an underdeveloped banking system and with even more deficient (or missing) non-bank financial institutions? And what was the right way to begin privatising an economy that was almost wholly state-owned?

The privatisation of an almost wholly state-owned economy was a task never before tried anywhere in the world. It was radically different not only from privatisations implemented in advanced market economies but also from those of developing countries. In the latter as well as in the former, state ownership has seldom extended far beyond certain sectors of the infrastructure (rail transport, motorways, telephone network, etc.) and "basic" industries (oil and gas, basic chemicals, some important sectors of mining, metallurgy, forestry, special fields of agriculture). Consequently, not much else could be privatised (Cook and Kirkpatrick 2003). In the processing industries and the building trade, there have been few state-owned enterprises (and where there have been, they usually have been very big units, such as car factories), and even fewer publicly owned companies could be found in trade and services. On this basis, in advanced and developing countries the usual method of privatisation was to reorganise the selected enterprises with layoffs, clean the output profile, etc., and then sell the enterprises (at the stock exchange or by tender [e.g., Welch and Frémond 1998]).

The analysis in Dewenter and Malatesta (2001) of a large sample of firms privatised in several advanced countries shows that productivity and financial results at the firms improve before privatisation (after the reorganisation), and the subsequent sale serves to maintain those results with the help of the discipline forced upon them by the new, private owners.³ Privatisations of this kind—"classical" privatisations—happened in all European former communist countries, but this method could not be applied as a general model. In these countries the institutional system, the culture of functioning of private property, was (of course) missing. There was no stock exchange, or even banks able to grant loans in ways that are usual in market economies. (Banks under communism had to finance the

³ Campbell (2002), citing quite a few sources, writes that efficiency also tends to improve after privatisation.

implementation of the [output, construction, etc.] plans forced upon them by the authorities, with little regard for the prospects of repayment of the loans granted or for the liquidity, solvency and profitability of the enterprises concerned.⁴) Controlling the reorganisation of all the firms to be privatised would have far exceeded the administrative capacities of the supervisory organs and the financing capacities of public budgets. And, if all firms had been offered for sale in the way described here, many of them would not have found a buyer.

2.3 Selling at equitable prices

In the previous section it was stated that, for various reasons, two important elements of the classical method of privatisation—the thorough reorganisation of enterprises before privatisation and the application of some basic institutions of the capitalist economy (most notably the sale at the stock exchange)—could not be applied on a sufficient scale in the European former communist countries in the period studied. A further important component of classical privatisation is selling at an equitable price. Its applicability in this scope of analysis will be the subject below.

The price (or valuation) of an enterprise (or a part of an enterprise) can have three different meanings. The first one is book value, meaning the costs of investments in establishing the enterprise reduced by the depreciation of its assets. The second meaning of the concept is the present value of the enterprise calculated from its expected future yields. Third is the price at which a buyer is found for the enterprise.

Book value has little relevance at privatisation, particularly under the circumstances that prevailed in the early 1990s in the countries studied here. Economic conditions determining the actual usefulness of existing enterprises were changing radically. The Council of Mutual Economic Assistance, the Soviet-dominated organisation for trade and economic cooperation between communist countries, was liquidated. Customs and other barriers of the trade with the European Communities (then becoming the European Union) collapsed. Trade was rapidly reoriented towards the European Union and some other Western countries. Prices of products and services, which previously were largely fixed, mostly began floating on the market. In the short term, all these changes further deepened the economic crisis whose origins had been in the communist regime, and which

⁴ See in more detail in subsection 6.2.3.

also contributed to reshaping the demand for the output of existing enterprises. Considerable production capacities built not long before became idle, often utterly useless; some others won good chances for further exploitation. However, besides the senseless book value, the other two versions of enterprise valuations (prices) were also problematic in the early 1990s in the countries studied.

As for the present value calculated from expected yields, it can always be calculated in various ways and contains important uncertainties. But in the countries studied here in the first years of privatisation, the calculation of the present value was subject to particularly large uncertainties, stemming from the radical changes of economic circumstances described in the previous paragraph. Future yields of firms were also uncertain because of fears of political instability and the unfinished transformation of the whole legal framework of the economy. Thus the present value calculated from expected yields was rather uncertain and was usually lower than the value that could have been calculated from past yields. And expectations concerning the future were varied, as they were built on different premises. Hopes for improving business conditions in subsequent years might have seemed well-founded: once the crisis ended, economic growth could be expected to restart, tremendous work on improving the legal system according to the needs of the market economy would likely bear fruit, and progress could also be made toward accession to the European Union. Those who believed in these elements of progress expected increasing yields of the enterprises and saw in them decent present values that could be calculated from these yields. However, paying a price based on these hopes was a tough decision for an investor. Hoping for an (unprecedented) smooth shift from communism to a market-based system was easier than investing one's own (and/or borrowed) money on such a bet.

The situation was further exacerbated by the fact that—even at the pessimistically calculated, i.e. low, prices—no buyers could have been found for a significant share of the firms (or parts thereof). One individual or household always has limited savings. In the communist era, incomes were limited, and large amounts of savings could not be accumulated. Because of shortages of goods and services, actual savings of certain strata of the population might exceed intended savings. However, inflation on the eve of and in the first years of transition largely melted down these—in any case rather limited—savings (e.g., Boone and Hørdér 1999). Thus, to possess medium-sized and large firms, savings of several, or many, households should have been merged into corporate forms, as is usual in advanced capitalist countries. But the corporate forms of owner-

ship were only then being created by governments and legislators. Large numbers of households could not be expected to invest their savings in the shares of state-owned enterprises reorganised into corporate forms. Very few domestic households and mostly only foreign investors were in a position to pay the prices calculated for medium-sized and large enterprises. But selling to foreigners was problematic in several respects. On the one hand, selling firms to foreigners always entails some degree of animosity. The countries studied here were no exception.⁵ Of course, the animosity may be motivated by more than national sensitivity, namely, fears of reorganisations of the firms by the foreign owners, possibly meaning redundancies. On the other hand—as already mentioned—the calculated price can always be calculated in different ways. The foreign investor, who was a stranger to the local legal order, customs and relationships, tended to overestimate the political, economic and social uncertainties of our countries, particularly in the very early phases of the transition and, consequently, his calculated price might be rather low. But even if he did not exaggerate the problems that a firm under privatisation would have to face in the future, he had to bear in mind the rather significant transaction costs involved if he had to control that firm far from his home country, and he had to deduct those costs from the price that he offered (or was ready to accept). The experts of government agencies responsible for privatisation and their superiors, including government ministers, understood all this. And they might have thought that these offers should have been accepted because the emergence of some foreign investors, particularly if their experiences were positive, would in turn attract further investors, and thus further companies might be sold at higher prices. Besides such considerations, a highly indebted government's urgent need for money might also have been an important reason for selling state-owned firms to foreign investors. Most likely, these two kinds of factors were the main reasons for the sale of *Egyesült Izzó és Villamossági Rt. (Tungsram)* by the Hungarian government to the American General Electric.⁶ And the idea did

⁵ Examples in the countries studied of protest against the sale of the national “family silver” to foreign owners are discussed in Sinn and Weichenrieder (1997).

⁶ Tungsram was one of the few large manufacturing enterprises in Hungary whose corporate structure was maintained after its nationalisation throughout the whole communist period. Until 1986, this was pure formality; it had no real consequence. (If it had had any consequence, it would have been changed, i.e., the firm would have been reorganised into a “normal” state-owned enterprise.) But after 1985, economic reforms within the still basically communist system became increasingly serious. One of the important changes was the development of the banking system. Bank loans to firms ceased to be financing

work—the mushrooming of investors began. Within the region, it became “fashionable” to invest mostly in Hungary. Before 1995, foreign direct investments in Hungary totalled US \$7 billion, not much less than in the Czech Republic, Poland, Romania and Slovakia combined (US \$7.7 billion) (Estrin 1996). This “Hungarian” method of privatisation (discussed below in more detail) was often explained by foreign researchers only by the high level of the country’s foreign debt (which at the time was almost exclusively public debt) and the consequent urgent need for cash (e.g., Lavigne 1995). They were only partly right. Starting with the very first case—that of Tungsram—the buyer assumed important investment commitments for the development of the enterprise (Holusha 1989). A third factor orienting Hungarian privatisation towards foreign investors was the relative openness of the Hungarian economy towards the West after the mid-1960s. On the basis of the latter, many Hungarian enterprise managers had experience with cooperation (such as licence purchases, and in some cases joint ventures) with Western companies, and were able to participate in the preparation of sales to foreigners (Drahokoupil 2008). Also, the “traditional” foreign partners were often interested in purchasing their Hungarian partner companies once they were put on sale.⁷

of the implementation of the plans forced upon firms by the authorities. The repayment of the loans and the payment of interests by the debtors became real requirements. Tungsram—at that time basically a producer of light bulbs—had severe difficulties because of the shrinking of its traditional markets (the other transition countries) and became highly indebted. Most other big companies were similarly struggling, also piling up large amounts of debt. But in Tungsram’s case—because it was a corporation, rather than a state-owned enterprise—the debt could be swapped for equity. In this way, Magyar Hitelbank, its lender, became its partial owner in 1987. This bank was state-owned; thus we might say that the state, previously direct owner of Tungsram, now became a partially direct, partially indirect owner. But two years later Magyar Hitel Bank sold its (minority) share to a consortium of banks led by the Austrian Girozentrale. Soon after this, General Electric announced its intent to purchase (in a first step) 50 percent plus one share of the company. Then (still in 1989) the government bought back the shares previously sold to the consortium of banks, and sold 50 percent plus one share to General Electric (Holusha 1989).

⁷ In Hungarian privatisations (particularly at sales, less so in preferential privatisations—as will be discussed below) investment and employment commitments were often requested from buyers. However, the Hungarian privatisation agencies’ orientation towards attracting fresh capital into the firms sold, maintaining employment levels and assuring high standards of environmental protection was not nearly as great as that of the German Treuhandanstalt, the agency established after the 1990 German unification to privatise the state-owned enterprises of the former German Democratic Republic. Hungary wanted to achieve revenue from privatisation (and it did, as is shown below). And the commit-

But the Hungarian policy of massive sales to foreign investors was rather exceptional. Though economists⁸ generally regarded this policy favourably, it was politically extremely delicate. For critics compared the prices of enterprises sold to foreigners (particularly the “introductory” prices applied in the first sales) to, for example, the price of a Manhattan apartment. Additionally, it was feared that in some cases the new foreign owners, with rather limited investments, would earn huge sums, creating an awkward situation. Thus, particularly at the beginning of privatisation, in countries other than Hungary, sales to foreign investors were limited.

Taking these economic and political limitations into consideration, it was difficult or impossible to sell medium-sized or big firms at what public opinion would consider a fair price. Besides what was said above, these kinds of sales were also hard because the interest of potential foreign buyers was restricted, particularly in the first years of transition, to better firms and mostly to Central Europe (and later extended basically to the Baltic countries). The political and economic impossibility of privatisation (only) by sales was well reflected, for example, in the Polish debates on privatisation. There, the idea of privatisation by sales, with restricted opportunities allowed to foreign investors, was defeated because, with the population’s limited purchasing power, the prices of the assets would have become very low. In other words, the savings would have become “overvalued”. This overvaluation was unacceptable because the communist *nomenklatura*, the participants in the black economy and private entrepreneurs held a large percentage of the savings, and a privatisation dominated by these strata as investors would have been highly unpopular and considered illegitimate (Baltowski and Mickiewicz 2000).

ments in question cannot only reduce this revenue, but can actually result in negative revenue (with privatisation-related state subsidies exceeding privatisation revenues). This is what happened with Treuhandanstalt. Thanks to pre-privatisation reorganisation costs, environmental protection guarantees and various commitments requested from the buyers of the state-owned firms, the agency’s work ended with the accumulation of a public debt exceeding 260 billion German marks (Gray and t’Hart 1998).

⁸ The basically positive role played by foreign strategic investors in privatisation is mostly only modulated by statements (and related explanations) that it is not always positive (e.g., Mencinger 2003).

2.4 Search for other equitable—preferential—solutions on the basis of political and ideological considerations

Once privatisation for cash was considered not equitable, the door was open to another concept of equity. According to this concept, equity meant giving state-owned firms (free of charge or at prices even lower than those that could be achieved in free sales) to those who somehow could *ab ovo* be considered the legitimate owners of those firms. In other words, the quasi-impossibility of classical privatisation led to the propagation of various non-traditional privatisation methods whose common denominator was the preferential treatment of some kinds of potential owners. Such preferential solutions were also supported by many Western experts, who often were advisors to governments of transition countries.⁹

The motto of the description below of preferential methods of privatisation might be Staniszkis' (1991) statement, "Without capital there is no rational privatisation".

Preferential patterns of privatisation included the granting of preferential loans (loans with government guarantees or interest subsidies; the debtor in both cases pays below-market interest rates). Such loans could be combined with other, sometimes also preferential, devices (e.g., leasing). Preferential privatisation loans could be granted to special categories of buyers of state property or to all domestic buyers.

However, the two most important patterns of preferential privatisation were the free distribution of property among all citizens, with the voucher method and the distribution of (a part of) the property rights of firms among their non-managerial employees and managers. As will be seen later, the two patterns were often combined. Still, in principle, important differences separate them.

Appel (2004, p. 115) states correctly that (in the Czech, Russian and Polish cases that she analyses) mass privatisation via vouchers was based on the commitment of the decision-makers to neoliberal ideology. As she writes, the motivation was not political:

"[V]oucher privatization was not a policy program merely intended to create a structure of ownership that would ensure the political survival of its advocates. ... power at this stage of privatization was not an end in and of itself."

⁹ Western advisory support was particularly strong for mass privatisation to all citizens via vouchers. However, as Appel (2004, p. 5) notes, "(m)any of these past advocates of mass privatisation are much less sanguine today".

Instead, Czech leaders after the Velvet Revolution of 1989, and Russian President Yeltsin's government ministers appointed in 1991, opted for mass privatisation (which they hoped would be rapid), "since it would anchor the transformation from public to private ownership and accelerate the transition from a communist to a capitalist economy".

Klaus, the "father" of the Czech (before 1993, Czechoslovak) mass privatisation, stressed that privatisation had to be implemented quickly, before opponents could organise and resist it:

"We know that we have to act rapidly because gradual reform provides a convenient excuse to the vested interests, to monopolists of all kinds, to all beneficiaries of paternalistic socialism to change nothing at all." (Klaus 1990, quoted in Appel 2004, p. 135.)

Mass privatisation could not be adopted either in Czechoslovakia/the Czech Republic or in Russia with the purpose of keeping the government in power. Nor could economic-efficiency considerations be the motivation. When these decisions were taken, there was no way to know whether available alternative solutions would have improved or reduced economic efficiency. Furthermore, as Appel writes, the reformers may have understood that rapid privatisation might be a politically risky or even suicidal strategy. Of course, the privatisers' commitment to neoliberal ideology was not free of political considerations. On the one hand, as mentioned above, the rejection (in the first phase of privatisation) of the classical pattern of selling the firms for cash was related to fears of a public backlash against the "bargaining away" of state property. On the other hand, the government PR on mass privatisation was not restricted to the advantages of rapid systemic change from communism to capitalism. On the contrary, the distribution of valuable assets to all citizens was always underlined. (On this basis quite a few authors attribute a bigger role to politics and less weight to ideology in the determination of privatisation policies and practices of European former communist countries even in the case of mass privatisation [e.g., Young 1997].)

The other most prevalent preferential privatisation method was privatisation to non-managerial employees and managers of the individual firms at low prices or for free—insider privatisation. Behind this method were basically political considerations; ideological commitments were much less important. To understand why, it is worth a brief look at the development of privatisation policy in Russia.

The liberal Russian government formed in 1991 first wanted to follow the classical method of privatisation for cash. From this approach, the government shifted to mass privatisation via vouchers, fearing that the

classical way might be too slow and that political developments might block the privatisation process. But then another turn, this time towards insider privatisation, became unavoidable. Deputy Prime Minister Gaidar and Minister for Privatisation Chubais opposed the privatisation of this kind categorically. One of their allies, Fedorov, stressed in June 1992 that they wanted capitalism, rather than “another Yugoslavia”,¹⁰ i.e., communism with workers’ self-management. Chubais himself has described his struggle against the insider privatisation model in several publications (e.g., Chubais 1999a). Still, as shown below, behind the curtain of a mostly voucher-type scheme of privatisation, the distribution of property according to citizenship became a largely insider privatisation.

Appel’s explanation of the latter turn is again largely ideology-based. But that explanation is not convincing. The insider solution was a victory for the trade unions and groups and organisations of company managers. According to Appel, they won the support of the mostly former communist members of Parliament, who “ideologically sympathised” with the idea of workers’ ownership. This statement is problematic for two reasons. First, the Communist Party of the Soviet Union previously (for seven decades before 1987) did not display any particular sympathy for workers’ ownership. In the Soviet Union, there were economic organisations formally under the control of labour: *kolkhozes* in agriculture and consumers’ cooperatives in retail trade. However, they had no more autonomy vis-à-vis the party-state planning and control hierarchy than state-owned enterprises. Even during the 1960s and 1970s, when the Kossygin reforms (temporarily and to a limited extent) increased enterprise autonomy, the self-management rights of the members of *kolkhozes* and cooperatives remained empty formalities, overruled by the actual paramount power of the supervisory communist party and government bureaucracy. On the other hand and more importantly, at the time of the 1989 election of the Russian Parliament, the “managerial revolution” mentioned above was already in full swing. One of the important manifestations of the “managerial revolution” was the increasing percentage of enterprise managers among the elected members of Parliament (from the already high percentage that it had been during the previous decades). (Accordingly, Boycko, Shleifer, and Vishny (1995) (two of the three authors were active participants in the process) describe the stubborn insistence of Parliament upon insider privatisation as the action of enterprise managers and trade union leaders themselves. It is only a mild exaggera-

¹⁰ As quoted by Appel (2004, p. 208).

tion to say that the managers (and trade union leaders) did not have to win the support of Parliament because they themselves were Parliament. And their support of insider privatisation was not based on ideological sympathy. They fought for it because it served their interests: this was the best way to strengthen their power over the firms. Later, this power helped them to increase their ownership share (Gatsios 1996). For managers, an important advantage of insider privatisation was the lack or weakness of the kind of external control that is usually present at manager–employee buyouts in advanced capitalist countries. These are usually leveraged manager–employee buyouts (often abbreviated as LEMBOs). Behind the leverage, there is a bank concerned about efficiency, solvency and liquidity. In Russia (and in the other countries studied here), insider privatisation could be implemented without borrowing (as shown below). Alternatively, borrowing from the government or with a government guarantee was assured under rather easy conditions (Filatotchev et al. 1999).

This sheds light on the critical role of politics in privatisation. Klaus and Triska in Prague, and Gaidar and Chubais in Moscow, wanted to privatise in similar ways, on the basis of similar ideological commitments. The Czechs were able to do it (even though, as will be seen, they also had to overcome resistance.) But the Russians faced political forces and a power structure that compelled them to largely give up their own ideas, and to a significant extent implement the proposals of their adversaries.

One feature of insider privatisation that has political implications was the fact that it left the final objective of privatisation obscure. Obviously, this did not hold for mass privatisation. It was obvious that after the implementation of the latter, a high percentage of citizens would sell the shares purchased with the vouchers given to them (or, if allowed, to sell the vouchers themselves), entailing the concentration of the ownership of enterprises, slowly or rapidly, in a limited number of hands. And there was no reason to expect anything but the convergence of ownership distribution to one of the above-described Western models of ownership structures. In other words, with voucher privatisation, capitalism was knocking on the door rather loudly. However, capitalism was not a consensual desire of the people in the countries studied here. (Granted, there were important differences among countries in this respect; public opinion was much more pro-capitalist in the Czech Republic than in Russia [Miller, White and Heywood 1998, p. 85]). At the same time, it was still possible to believe that insider privatisation would leave the way open towards some kind of cooperative ownership model, towards something other than capitalism. Baltowski and Mickiewicz (2000, p. 429) refer to

this (although they suggest that the obscurity of the final objective also holds for mass privatisation):

“The political decision to opt for the non-equivalent privatisation of state enterprises [i.e. mass privatisation or employee privatisation—K.A.S.], irrespective of its economic viability, was already perceived as highly probable in the autumn of 1989, given the fact that the consensus of the Round Table talks was not pro-capitalist in character.”

A further issue of equitable privatisation has been restitution or partial compensation for confiscated property. This book does not address that issue in much detail, since the solutions accepted in the countries¹¹ discussed here did not have a major direct impact on the privatisation of large and medium-sized firms. Nowhere in these countries were these firms given back to their original owners in their physical form. In Hungary and Slovenia, compensation was given in the form of vouchers to be used in privatisation deals. These vouchers increased the demand for the shares of all enterprises, including medium-sized and large ones. However, their influence on the composition of the demand must have been negligible, because the compensation vouchers could be sold and purchased freely; they were even quoted at the stock exchanges (for vouchers distributed in mass privatisations, this was not always allowed). Prices of compensation vouchers fluctuated depending on the development of “privatisation supply” and on the sometimes changing conditions of their use in privatisation. But the prices were always below the vouchers’ nominal values. They ended up in households or other entities that wanted to purchase privatised assets anyway. With the vouchers bought at discount prices, buyers could purchase these assets somewhat more cheaply (assuming that this rather strange increase of their purchasing power did not push privatisation prices upward).

Applying preferential patterns of privatisation definitively deprived the state budgets of the countries concerned of significant privatisation revenue. The other—not definitive—consequence of such privatisations was the birth of ownership structures unprecedented in the international history of the market economy. These structures were unsustainable. Firms began to be owned by legions of small owners in countries that had little or no protection of the interests of small owners. This ownership structure had to disappear sooner or later: the shift towards more concentrated ownership of firms—secondary privatisation—was unavoidable.

¹¹ In the four Central European countries, as stated above, this issue was not solved, and not even seriously raised, in Russia and Ukraine.

An overview of the processes of primary privatisation in the six countries

The countries studied here implemented primary privatisation with a wide range of methods. Systematising the paths followed by different countries is not an easy task. In analysing the economies of former communist countries, an approach based on relatively homogeneous country groups—determined by geography, history, mutual and common external relations—is useful in many respects. For example, in the development of intra-industry trade with the 15 pre-2004 member countries of the European Union, the five Central European countries (the four in this study and Slovakia) have achieved various levels but much higher ones than the other countries. The second group on this count are the Baltic countries (Estonia, Latvia and Lithuania), in a tie with Balkan countries (Romania, Bulgaria, Croatia). The worst performers are Russia and Ukraine, together with some other former Soviet republics (Fertő and Soós 2008a). Another example of analysis by country groups is the annual “Transition Reports” of the European Bank for Reconstruction and Development (e.g., EBRD 2008), which distinguish three somewhat differently determined groups with respect to their progress in transitioning towards a market economy: the Central European and Baltic countries, the Southeast European countries (Albania, Bosnia and Herzegovina, Bulgaria, Croatia, Macedonia, Montenegro, Romania and Serbia) and the Commonwealth of Independent States (Russia, Ukraine and other former Soviet republics).

However, in analysing privatisation during the 1990s, such groupings of the countries would be useless. For example, although Czech privatisation followed a path rather different from Russian privatisation—at least at first glance and restricting the question only to primary privatisation—the Czech way was nevertheless closer to the Russian way than to the Hungarian one.

Privatisation patterns also varied widely within individual countries. On the one hand, compromises between different ideas and interests and also important differences among the enterprises under privatisation resulted in the parallel application of different methods. On the other hand, the application of any method revealed its negative features, and the noisiest groups were always those whose interests were harmed by the methods applied. Because of such factors, the methods and principles of privatisation often changed—mostly when new governments took power.

3.1 Primary privatisation leaving limited space for secondary privatisation—Hungary

During the 1990s, the objectives and methods of privatisation changed less in Hungary than anywhere else (not only among the six countries studied but more widely, among European former communist countries). Successive governments harshly criticised the privatisation policies and practices of their predecessors, but basically continued along the same lines. In the selection of privatisation methods, assuring revenue for the government budget played an important role. Privatisation revenue was used to reduce the public debt (but that does not mean that the public debt could not be increased in other ways). Table 3.1.1 shows that between 1989 and 1999, the cumulative sum of privatisation revenues in Hungary (measured in percent of GDP) exceeded that of the five other countries combined. For bigger firms, the main pattern of privatisation was sale to strategic investors (selected through tenders). Those investors were mostly foreigners. Hungarian investors, particularly in the early period, could seldom play this game because they could not afford it. In the first period, foreign investors' penetration did not meet significant resistance. In 1991 a public opinion poll showed that a decisive majority supported the government's policy of attracting foreign capital to Hungary (although those polled probably imagined the inflow in the form of greenfield investments, rather than purchases in privatisation). But in subsequent years this support diminished rapidly.¹

¹ Every year, a representative sample of the adult population was asked to what extent the inflow of foreign capital should be encouraged. The average value of the answers was 3.78 on a scale from 1 to 5 in 1991 and only 3.03 in 1995 (Angelusz and Tardos 1997, p. 16).

Table 3.1.1 The cumulative amount of privatisation revenues of the six countries, calculated in percent of GDP

	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Czech R.	0,0	0,0	0,0	0,0	2,6	5,3	7,1	8,7	9,4	10,2	11,5	12,3	14,8	20,0	21,0
Hungary	0,0	0,0	1,3	3,9	8,7	12,3	20,9	23,4	27,5	28,6	29,8	30,2	30,6	30,7	31,6
Poland	0,0	0,0	0,2	0,6	1,1	1,9	2,7	3,6	4,8	6,0	7,2	10,8	11,6	11,9	12,4
Slovenia	na	na	0,0	0,0	0,0	0,0	0,4	0,7	1,2	2,0	2,2	2,4	2,5	4,7	4,8
Russia	na	na	na	0,8	1,1	1,3	1,5	1,7	2,8	3,5	3,6	3,9	4,3	4,7	5,4
Ukraine	na	na	na	1,2	1,3	1,3	1,4	1,7	1,8	2,3	2,9	4,3	5,5	6,0	7,1

Source: European Bank for Reconstruction and Development

Employee ownership would have received the strongest public support. In May 1991, a poll found almost 50 percent support for this solution (within that, more than a quarter of those polled “voted” for exclusive employee ownership; less than a quarter preferred combined employee and private investor ownership) (Hann and Laki 1992, p. 189). Later, at least until 1995 (no later data are available), this support of employee ownership further strengthened (Angelusz and Tardos 1997). However, in the initial years no special device was established for such buyouts, and no preferential conditions were available. The anticommunist government established after the 1990 free elections did not support such solutions, not only because it wanted to avoid any reduction of privatisation revenues but also because employee ownership would have strengthened the positions of enterprise managers. Although a very high percentage of the latter had become managers only some years earlier, and had been selected increasingly on the basis of professional competence, rather than political criteria, most of them were members of the communist party until 1989 (Lengyel 2003). Managers did not receive any special preferential treatment for buying shares of their firms, although (with some politically motivated fluctuations) they played important roles in the preparation and implementation of privatisations (and they could exploit these roles to obtain important advantages, e.g., to maintain their positions under the new private owners). Employees (of course, including managers) received stakes in their firms free of charge. (However, the stakes seldom exceeded 10 percent, and in practice, they functioned as a one-time supplementary wage, because in most cases the workers immediately sold the shares received.)

There was no mass privatisation via vouchers. Partial and degressive compensation for confiscated property was granted in the form of compensation vouchers that could be used in privatisation instead of cash.

The first actual appearance of privatisation was spontaneous privatisation, which—as mentioned in subsection 1.2—was largely not truly spontaneous and only marginally meant actual privatisation (Móra 1991 and Mihályi 1998). Voszka (1998) demonstrates that the reorganisation of enterprises into groups of companies usually helped improve management and the administration of enterprise debts, whose accumulation was a serious problem in the early 1990s. Nevertheless, abuses did happen, and public opinion reacted strongly. Thus privatisation as such became suspicious before it really began; debates about the role of enterprise managers in privatisation started in reaction to the stories of abuses. Months before the first free parliamentary elections of March–April 1990, a State Prop-

erty Agency was established; its task was preventing abuses in the corporatisation–privatisation process. After the spring 1990 elections, with the new government’s more centralised privatisation policy, the Agency received a more ambitious function: it had to control and manage privatisation. In the next year, ownership rights over state-owned companies were allocated to the agency (from government ministries and self-management bodies called workers’ councils). With the gradual corporatisation of all state-owned companies, the agency became their shareholder. In 1992, control over those firms that were supposed to be maintained long-term in state property was reallocated to the State Property Holding Company (SPHC). However, the list of the latter, not-to-be-privatised, firms was regularly revised and reduced. Consequently, the SPHC became a second privatisation agency. This strange situation was normalised in 1995, when the two agencies were merged in the State Privatisation and Holding Company.

The sales of larger firms to strategic investors also began in 1988–1989, soon after the beginning of spontaneous privatisation. (However, in the first example—the sale of Tungsram’s majority share to General Electric—the strategic investor arrived with the mediation of a consortium of financial investors: see subsection 2.3.)

Enterprise managers were allowed to prepare privatisation deals with investors (including foreign ones) with the participation of their sectoral ministries and the State Property Agency. Decisions, agreements and contracts were subject to approval by the ministries or, from 1990 on, by the Agency. In 1990 the new government sought to oversee the privatisation process more closely. With the announcement of the “First Privatisation Program” and at the beginning of 1991 of the “Second Privatisation Program”, involving 34 firms in all, several ongoing privatisation deals were blocked in the hope of a better-organised process of sales. However, by the deadline, not even a tenth of the firms included in the two programmes were sold (Major 2003).

The strict central control made privatisation slow. The government wanted to accelerate it and largely rehabilitated the active role of enterprise managers in the autumn of 1991. The self-privatisation programme was born. In the framework of this programme, consulting firms were selected by the State Property Agency as usual (the agency was assisted by such a company in each privatisation deal). The essential innovation of this programme was the agency’s passive role: there was a rule that the firms’ managers themselves had to negotiate and sign the contract with the advisory company about the latter’s tasks, i.e., the basic conditions of

the privatisation (this is why this programme was called “self-privatisation”). In the first phase of the programme, only firms employing fewer than 300 people were included. In the second phase, from August 2002, this limit was raised to 1,000, and the number of companies involved to 749 (Mihályi 1998).

In 1992–1993, the sale of big companies (in engineering, chemistry, tobacco, textile industry, etc.) to foreign strategic investors went quickly (even the first of the natural monopolies, that of the Hungarian Telecommunication Company, or Matáv—now T-Home—was partially privatised in 1993), and the shares of six companies were sold at the stock exchange. However, these were also the peak years of preferential privatisation in this country (Sárközy 2005).

All domestic buyers in privatisation were eligible for preferential privatisation credit—also known as E-credit.² The Employee Partial Ownership Program (EPOP) was introduced. Before the EPOP, employee buy-outs occurred only at small companies with low capital intensity. Companies privatised in this way employed highly qualified workers valued for their professional competence (Karsai 1993). But now, on the basis of the EPOP, a group of employees could assume partial ownership of their firm through a privatisation tender, yet under preferential conditions. For the buyout they received E-credit that they (and, among the grantees of E-credit, only they) could repay from their company’s untaxed profit.

However, the appearance of new preferential methods of privatisation did not entail the development of really peculiar and obviously transitional—e.g., highly dispersed—structures of ownership. The main preferential device was E-credit, and even though the conditions regulated its granting to different participants, those conditions were secondary. And basically, E-credit was accessible to all domestic private persons and companies (even foreign-owned companies registered in Hungary; legally they could not be discriminated against vis-à-vis other Hungarian companies).

Privatisation for compensation vouchers also accelerated, parallel with the increase of preferential privatisation devices. The vouchers could be

² The “E” in E-credit was an abbreviation for “existence”. Originally, it was introduced to help buyers in the “small-scale privatisation” (which in Hungary was called “pre-privatisation”) of shops and very small companies. There, only private persons could be buyers, creating for themselves new livelihoods—“existences”—as shopkeepers and small entrepreneurs. But in 1992–1993, access to E-credit was widened to corporations, and the limits of the amounts of credit that could be granted were abolished.

exchanged for arable land (only by the person who received the compensation) under extremely advantageous conditions. This was very attractive for many concerned. Consequently, the compensation process significantly influenced the privatisation of arable land, contributing to the emergence of small and very small land holdings and becoming one of the reasons for the large drop in agricultural production. But the majority of the compensatees did not want arable land. Instead, they sold their vouchers (mostly via the stock exchange), far below face value. In privatisation deals, these vouchers were exchanged at face value (plus interest). But whenever the privatisation agency found that purchasing with vouchers was “too advantageous” for the buyers in a certain deal, it limited the proportion of the price that could be paid with vouchers.

As for the Employee Partial Ownership Program, its extent was rather limited. At its peak in 1993, 121 companies were privatised in its framework. In 1994 that figure was 66 companies. These privatisations yielded 17 and 11 percent of privatisation revenues, respectively. The companies were mostly middle- and lower-medium-sized, and some of the deals were hidden managerial buyouts. Furthermore, as Mihályi (1998) demonstrates, for these companies there were usually few or no other applicants who would have pushed their prices upward. And so the prices tended to be far below book values. Under such circumstances loan repayment was not a heavy burden on enterprise profit. Consequently the ownership structure was transformed (towards higher degrees of concentration) rather quickly (until the repayment of the loan, the employees owned the shares of the firms indirectly, via an Employee Partial Ownership Organisation.)

In 1994, an election year, privatisation decelerated, just like four years earlier; the self-privatisation method was abolished. (The negative correlation between elections and privatisation revenues is demonstrated and discussed by Karsai [2005].)

The new government’s privatisation strategy urged the rapid completion of privatisation. In 1995 the new government introduced “simplified” privatisation. This was similar to self-privatisation but gave enterprise managers an even more important role. As trustees of the State Privatisation and Holding Company, the enterprise managers could implement the privatisation of their companies. For companies with more than 500 employees, participation in this programme was mandatory. The Employee Partial Ownership Program remained in effect but lost its popularity; each year only some companies chose this privatisation pattern.

The new law on privatisation, also adopted in 1995, brought some radical changes. The not-to-be-privatised share of state-owned enter-

prises was determined in the 1992 privatisation law at approximately 35 percent (in value terms). Now, with the exclusion of many enterprises from this sphere, this percentage was reduced by more than half, and the remainder had to be privatised “as soon as possible”. This law also ordered the sale of minority shares that remained from previous (partial) privatisations, except in cases of firms of “strategic” importance. Additionally, it stressed the priority of privatisation for cash (i.e., the limitation of the application of preferential methods). Fourteen companies of the energy sector (more precisely: partly strong minority shares and partly weak majority shares of these companies) were sold to foreign strategic investors in 1995. Thanks to the latter, privatisation revenues were bigger than in any previous or subsequent year (see Table 3.1.1). However, after the 1994 slowdown, sales of medium-sized and lower medium-sized companies did not pick up again until 1996 (Voszka 1996). Some large companies were privatised to financial investors, not including strategic ones (among them, large portions of the shares of eight companies were sold at the stock exchange in 1995–1997). This series of sales assured (mostly deliberately) strong positions for the managers of the companies, most of whom had once been in the communist party. And in this period, the government was essentially controlled by the Hungarian Socialist Party, the successor of the former communist party. Privatisations of a similar kind would hardly have been possible under the previous right-wing government. But it is important to note that direct property rights or any formal preferences were never granted to managers in Hungarian privatisations—not even at these enterprises (Voszka 1997b).

Table 3.1.2 shows the development of ownership shares of Hungarian companies between 1992 and 1998 within the largest category of companies in which this can be measured: those applying double-entry book-keeping. The increase of Hungarian individuals’ stakes in this period, from 9.8 percent to 12 percent, might seem rather small. However, this figure is a little misleading. First, many of the companies owned by other companies (whose share was increasing) were indirectly owned by Hungarian individuals. (Their only significant “competitor” in this respect was the state, whose proportion was obviously shrinking, rather than increasing. Among foreign-owned Hungarian firms—which, of course, are considered Hungarian firms—it is rather uncommon to own [partly or wholly] other firms [Tóth 1998]). Second, the increase of the proportion of foreigners in the invested capital stemmed only partly from acquisitions. Green- and brownfield investments were also important destinations for

foreign investments,³ implying that the proportion of Hungarian individuals in invested capital was a proportion of an increasing total. This suggests that the absolute value of the invested capital of Hungarian individuals grew significantly. But of course, the really spectacular change was the huge drop in the ownership share of the state (the central government) and the huge increase in foreign ownership. Furthermore, the share of cooperative and Employee Partial Ownership Organisation property was minimal.

Table 3.1.2 The development of ownership shares of all Hungarian companies applying double-entry bookkeeping between 1992 and 1998 (in percent of total invested capital)

Owner	1992	1993	1994	1995	1996	1997	1998
Hungarian individual	9,8	11,9	12,3	12,4	11,6	11,3	12,0
Domestic company	12,4	14,2	17,1	19,9	20,5	24,1	27,2
Cooperative	2,8	2,6	2,6	2,0	1,8	1,6	1,6
Employee Partial Ownership Organisation	0,1	0,3	0,9	0,9	0,8	1,2	0,4
Total domestic private owners	25,1	29,0	32,9	35,2	34,7	38,2	41,2
Foreign owner	10,1	16,1	18,9	28,4	31,5	35,3	39,1
Total private owners	35,2	45,1	51,8	63,6	66,2	73,5	80,3
Central government	58,9	48,4	40,4	29,5	22,4	15,8	10,4
Local governments	5,1	5,8	6,6	5,9	10,2	8,9	6,9
Other	0,8	0,7	1,2	1,0	1,2	1,8	2,4
Total for governments and other	64,8	54,9	48,2	36,4	33,8	26,5	19,7
Grand total	100,0	100,0	100,0	100,0	100,0	100,0	100,0

Source: Voszka [2003]

Voszka (2003) found that in 1997, from among the 100 largest companies, foreigners held stakes of more than 5 percent in 75. The state held such stakes in 37 of them, Hungarian private individuals in 30, domestic companies in 27, Employee Private Ownership Organisations in 14 and Hungarian financial investors in 12. Foreigners ranked first not only in number but also according to ownership shares, and (even in 1997) the state also had quite a few dominant shareholder positions. Employee Partial Ownership Organisations owned shares exceeding 25 percent in six companies (among them more than 50 percent in three) (see Table 3.1.3). These figures suggest that outsider owners had a preponderant weight. A further

³ Some indirect evidence of this can be found in investment data. The investments of foreign-owned firms accounted for 30 percent, 49 and 62 percent of total Hungarian investments in 1991, 1993 and 1995, respectively (Kaminski and Riboud 2000).

significant sign of the latter is the fact that, among the members of the board of directors, there were very few employees other than the general director (i.e., the latter might or might not be a significant owner, but other employees, who were not board members, could hardly be).

Table 3.1.3 Ownership types of the Hungarian “top 100” according to owners and ownership concentration in 1997

Type of dominant owner	Ownership share			
	Dominant with			Total
	25,01–50,0%	50,01–90,0%	90,1–100%	
	share	share	share	
Foreign firm	13	6	44	63
State	0	3	11	14
Domestic firm	3	1	5	9
Employee Partial Ownership Organisation	3	3	0	6
No dominant owner				8
Total	19	13	60	100

Source: Voszka [2003]

Table 3.1.4 Types of companies by the dominant owner in Hungary in 1997 (N=549)

Owners	Percent	Number
Foreign owner	23,3	128
Central or local government	16,6	91
Company	16,9	93
Small shareholders or cooperative-type ownership	8,2	45
Managers and non-managerial employees	23,9	131
Private person	11,1	61

Source: Kovách–Csité [1999]

Kovách and Csité (1999) found, among 549 firms selected from the database “Magyarország nagy- és középvállalatai 1996” (1996), that Employee Partial Ownership Organisations were most frequently dominant owners, closely followed by foreigners; domestic firms and central and regional governments were also well represented (see Table 3.1.4). However, these firms’ sizes varied widely; the data presented above on the companies applying double-entry bookkeeping and on the “top 100” char-

acterise Hungarian privatisation better, reflecting that it generated only limited insider (manager–employee) ownership (see on this issue Campbell [2002] and Voszka [2003]).

Table 3.1.5 The distribution of Hungarian middle-sized and large companies according to the number of owners and the presence of an owner exceeding 50 percent share in 1995 (N=210, data in percent)

Number of owners	Distribution of companies	Share of companies having a majority owner in the total number of companies
One	19,0	19,0
Two	31,0	29,0
Three	25,2	19,0
Not more than three	75,2	66,2
More than three	24,8	14,8

Source: Tóth [1998]

Finally, Table 3.1.5 shows the highly concentrated ownership structure following the privatisation in Hungary.

3.2 Primary privatisation—the Czech Republic

Among the privatisations studied in this book, the one implemented in the Czech Republic was the one most definitively directed at curbing the role played by the former *nomenklatura*, and at preventing the latter's transformation into owners of the privatised state property. According to Schöllmann (2001), the whole privatisation policy was determined mainly by the intent to replace as much of the economic elite as possible. The author shows in an example that such considerations dominated even nationalist political thinking, which played an important role in the formulation and promotion of the privatisation strategy. Namely, he cites the example of the privatisation of a big chemical factory that Czech managers wanted to sell to themselves. And they organised a strident propaganda campaign for this as the “Czech solution” against the sale of the company to foreign investors. The final decision—taken at the highest level—was sale to foreign investors; this was accompanied by anticommunist propaganda.

The main thrust of Czech privatisation was, however, not sale to foreigners, but rather free distribution among Czech citizens. The strategy of

this mass privatisation was announced by Minister of Finance (later Prime Minister) Klaus as one of the basic engines of re-entry into (Western) Europe. In this sense it was a European strategy, while being, at the same time, a specific Czech (before 1993, Czechoslovak) programme. Here the attribute “European” meant neoliberal ideology; Czech (Czechoslovak) meant that property, at least in the first years, was to be given to domestic citizens⁴ (even though significant exceptions to the latter principle did occur, e.g., the sale of the Skoda car factory of Mlada Boleslav to Volkswagen AG). Foreigners were excluded from the vast majority of privatisation, probably because selling mass amounts of property to them was expected to be domestically unpopular.

Already by the spring of 1990, Klaus had had his first major clash with the alternative privatisation plan of Komárek (who, as deputy prime minister, became his superior in the government). The Komárek plan foresaw slow privatisation, based on the reorganisation of firms. Klaus’s plan turned out to be more convincing, because it was a comprehensive plan of economic transformation (but later Klaus had to go through the same struggle with Minister of Industry Vrba). Then he argued at length against insider privatisation, which—as was seen in section 2.4—he believed served those favoured by the *ancien régime*.

In the Czechoslovak/Czech mass privatisation model, the privatisation of individual firms was based on projects. A project for the privatisation of a firm could be submitted by any individual or group. The latter rule was a victory over managerial groups and their representatives, who had lobbied to restrict the authorisation to submit privatisation projects to the managers of the company concerned. But the other side of the coin was that in most cases the managers’ projects were accepted (Appel and Gould 2000). In the short term, the services of managers were needed, not all of them could be removed on the basis of their roles in the communist power hierarchy, and an all-out war against them would not have been a good idea. To calm them, Klaus and Třiška, the head of the privatisation agency (the National Property Fund), explained several times that mass privatisation was leading towards a dispersed ownership structure, assuring strong influence for the managers. (Of course, this argument was also directed against the classical privatisation pattern of selling, which was more burdensome and risky for managers [Appel and Gould 2000]).

⁴ As Drahekoupil (2008, p. 181) writes, “a mix of economic nationalism and neoliberalism was not contradictory” from the perspective of Klaus and his colleagues. See also Myant (2003).

Mass privatisation essentially consisted of two steps: the distribution of privatisation vouchers to citizens and the exchange of the vouchers for shares of (medium-sized and large) firms. Citizens could perform the latter exchange directly or via Privatisation Investment Funds (PIFs). In the former case, they became direct shareholders of the privatised firms, whereas in the latter case, they became shareholders of the PIFs which, in turn, became shareholders of the firms. Spending the vouchers of all workers, including managers, of individual factories in a coordinated way to become “self-owners” (which, as will be seen below, was systematically promoted, and became the basic method of privatisation in Slovenia, Russia and Ukraine) happened only sporadically. Privatisation to workers was heavily promoted in the 1990 and 1992 economic programmes of left-wing political parties, but those parties lost the elections. Trade unions were also eager to support some kind of insider solution, as they did in other countries. However, in Czechoslovakia their support was—if not a poisoned chalice—useless at best. They were unable to win political influence because, at the beginning of the Velvet Revolution, in November 1989, they supported the communist leadership’s firm rejection of political or economic change. According to Appel and Gould (2000), before the country’s split, sporadic strikes and other actions were organised to promote employee ownership in the framework of the privatisation. These actions were supported by many enterprise managers but nevertheless failed to influence the government’s policies.

The (basically) voucher privatisation was implemented in two waves. The first one was implemented in 1991–1992 (still in the unitary Czechoslovakia, then officially called the Czech and Slovak Republic). The second wave, in 1994–1995, was restricted to the Czech Republic (and cancelled in Slovakia, which was then already a separate country). The priority of the voucher method was not a formal rule. The 1991 privatisation law foresaw several other patterns of privatisation. The starting point of the privatisation of an enterprise was the elaboration of the above-mentioned project(s). The project(s) had to be submitted to the relevant sectoral ministry. Adding its comments and proposals, this ministry forwarded the projects to the decision-making Privatisation Ministry. The latter’s decision was then implemented by the National Property Fund. The projects might propose full or partial privatisation, the split of larger companies and the application of various privatisation patterns, as well as their combinations for the company or for its individual parts. The applicable patterns were: auction, tender, direct sale, free transfer (to pension funds or lower-level governments) and, of course, corporatisation.

Voucher privatisation was related to the latter, because if the corporation was established as a public limited company, then its shares at least partly could be sold (exchanged) for vouchers. And this at least partial application of the voucher method was, for all practical purposes, a requirement. With this, stock market capitalisation reached 29.6 percent of the GDP in 1996, much higher than, e.g., in Hungary (12.4 percent). But the companies quoted at the stock market were small ones on average. According to Weiss and Nikitin (1998), in the United States there is roughly one publicly traded company per one billion dollars of the GDP, whereas in the Czech Republic this ratio was 30 publicly traded companies per one billion dollars of the GDP in 1996. Of course, this implied a quite specific “quality” of the stock market. As the authors remark, the liquidity of the market was rather limited, restraining the transparency of the market, but transparency was also restrained by the fact that it was permitted to trade shares outside the stock market.

By the end of voucher privatisation in June 1995, 2,110 auctions, 1,351 tenders and 10,899 direct sales were accomplished or started (see Table 3.2.1). Auctioned were parts, buildings and equipment of firms with an average value below 4.5 million koruny (US \$180,000); this part of the privatisation, for all practical purposes, became part of the “small privatisation” of shops, small trade and catering units and the like. The directly sold companies were bigger, and those sold via tenders even more so, but they were still rather small on average, amounting thus to a rather small share of “large-scale privatisation”. The lion’s share was privatisation via transformation into public limited companies. The average size of the firms privatised in this way was 408 million koruny, approximately US \$15 million.

The share designated for voucher exchange of the joint-stock companies established in the first wave (1991–1992) had a book value of 212.5 billion koruny, and about 8 million adult citizens were entitled to purchase vouchers. Thus a voucher owner could receive property valued at approximately 26,600 koruny, while he or she had to pay only 1,035 koruny for the voucher—a rather good return. Still, until January 1991, weeks before the deadline for application, only 20 percent of those entitled bought their vouchers. However, this share increased to 75 percent (5.98 million people) in that remaining short period. The increase followed the establishment and aggressive advertising campaign of the first (above-mentioned) Privatisation Investment Funds (PIFs). These funds pitched the privatisation deal to citizens as easy money. Some funds promised up to a tenfold yield within one year. In the first wave, 72.2 percent of the

vouchers were collected and invested into enterprise shares by PIFs. In the second wave of 1993–1994, the overall interest of the public did not decline (the number of participants was 6.16 million), but a somewhat higher proportion opted for direct participation in the privatisation; the share of mediation by PIFs fell to 63.5 percent (Kočenda and Valachy 2001).

Table 3.2.1 An overview of the process of large-scale privatisation in the Czech Republic

	Book value June 1993 millions of koruny	Number of units June 1993	Book value June 1994 millions of koruny	Number of units June 1994	Book value June 1995 millions of koruny	Number of units June 1995	Book value June 1996 millions of koruny	Number of units June 1996
All property	607635	4893	922041	16071	950463	20917	963453	22190
Auction	5634	431	10057	1714	9378	2110	9360	2054
Tender	16434	424	27931	887	31236	1351	36544	1750
Direct sale	38016	1359	86407	7713	90463	10899	90156	11436
Joint stock company	534779	1327	756008	1897	765941	1875	774955	1914
Free transfer	12772	1352	41998	3860	53445	4700	52438	5036

Remark: the data are cumulative, and they include, beside accomplished sales (and transfers), the companies, and parts of companies, prepared for sale

Source: Kočenda–Valachy [2001]

Before issuing the shares, the companies published information booklets describing their activities, assets, prospects, and so on. In the first wave of the distribution of the shares, voucher owners (citizens and PIFs) could subscribe shares at prices corresponding to the book value of the firms. If all the shares on sale were not subscribed, the National Property Fund held the remainder for later sale. In cases of over-subscription, the amounts of shares allocated to all interested parties were reduced proportionally. However, if the over-subscription exceeded 25 percent, then the procedure was repeated at higher share prices, and if it was needed, it could be repeated three times. In the first wave, shares worth 212.5 billion koruny (roughly US \$8 billion, 7.5 percent of total state property) of 988 companies with a total share value of 331 billion koruny were exchanged for privatisation vouchers. In the second wave, shares worth 155 billion koruny (4.5 percent of total state property) of 861 companies were allo-

cated in the same way. The total value sold by the state in large-scale privatisation was roughly 700 billion koruny, more than 60 percent of which was exchanged for vouchers (World Bank 1999a).

Small-scale privatisation was excluded from voucher privatisation in Czechoslovakia/the Czech Republic, meaning that this pattern was restricted to large-scale privatisation. However, within the latter, the exchange for vouchers usually extended to a lower proportion of the shares at bigger firms than at smaller ones; at the latter it often reached 100 percent.⁵ Additionally, firms sold for vouchers at higher proportions tended to be worse ones.⁶ (And the telephone company, the coal and other mines, the energy sector and the banks were not included in voucher privatisation; the government did not want to privatise them without proper reorganisation [Mejstřík 2003]).

After the first wave of voucher privatisation, the National Property Fund held more than 20 percent of the shares in 56 partly privatised companies (with the intention of selling them later). In 40 companies, foreign or domestic strategic investors held more than 20 percent (including 19 cases in which foreign investors held more than 50 percent) (Mejstřík 2003). However, the largest shareholders (primarily with respect to the number of companies but not as large if measured in share values) were Privatisation Investment Funds. In 102 companies, one PIF held 20 percent or (in violation of the law) more than 20 percent of the shares. Not more than two PIFs held more than 20 percent of the shares in 673 companies. In about 400 companies not more than four PIFs held over 40 percent of the shares (Kočenda and Valachy 2001).

The number of PIFs was about 400 during the first wave (in Czechoslovakia). During the second wave, the number was 354 (in the Czech Republic). During the first wave, PIFs could only be established as joint-stock companies. Later, for the second wave, the establishment of PIFs

⁵ In a sample of 565 companies, the median value of the proportion of exchange for vouchers was between 80 and 90 percent in the two waves. However, the weighted mean of the same indicator was about 50 percent (Marcincin and van Wijnbergen 1997).

⁶ Marcincin and van Wijnbergen (1997) examined 565 companies, a quarter of all those subject to voucher privatisation. After their privatisation, in 335 of the companies there were significant non-voucher owners: the National Property Fund, or a local government, or a person who was compensated for property confiscated in the communist period held shares exceeding 20 percent, and/or a non-resident legal entity or physical person held shares of any amount in these companies. The other 230 companies, which were exchanged for vouchers in higher proportions, and had no foreign owners, had lower profitability and weaker capital base than those 335.

was also allowed in the form of open-ended and closed-ended funds. But the number of open-ended funds was very limited. And for practical purposes, closed-ended funds and joint-stock companies were rather similar to each other. The share of the joint-stock company, as well as that of the closed-ended fund, could only be sold to a third party: the investor could not sell his or her share to the joint-stock company or to the closed-ended fund.⁷

Each Privatisation Investment Fund had to invest in at least 10 companies and could not invest more than 20 percent of its capital into any individual company. In order to reduce the risk of the emergence of conflicts of interests, no other activities were allowed for these companies of specific kind but beyond this, their regulation was rather loose. No separate agency was established for the supervision of the capital market; the latter was the task of the Ministry of Finance, which was not particularly efficient in this field. Thus this market became rather notorious; abuses and scandals abounded. This will be examined in more detail below. Here let me only mention how the National Property Fund set the example for such behaviour. In the first wave of voucher privatisation, the physical distribution of the already auctioned shares was postponed by several months. During this period, the NPF was the custodian of these shares but a rather bad one. For at 458 companies (more than half of them) it “increased” the share capital. In other words, it diluted the value of the shares. And it partly sold the “surplus” created in this way to foreign investors (Myant 2001).

Another important flexibility in the regulation of the Privatisation Investment Funds was the freedom of state-owned banks and insurance companies to establish their own PIFs. Not surprisingly, the largest PIFs were established by them. At the end of the first wave, the 14 largest PIFs held 78 percent of the total invested capital (the total number of privatisation vouchers); within that the five largest ones held 69 percent, with the largest one alone holding 16 percent. From among the 14 largest, nine were established by banks. The PIFs established by the Czech banks known as the “big four”—Česká Spořitelna, Komerční Banka, Investiční Banka and Československá Obchodní Banka (CSOB)—and by the large insurance company Česká Pojišťovna acquired 32 percent of the vouchers (a bit more in the first wave, less in the second wave). Thus state property

⁷ In the Czech Republic, as well as in most other countries, joint-stock companies were allowed to buy their own shares within certain limitations. However, they were never obliged to do so.

was partly only transferred into another, to some extent different, state property; Stark (1995) calls this phenomenon “recombinant property”.

Other analyses (e.g., Lieberman et al. 1995, Claessens 1995) emphasise that for those Privatisation Investment Funds related to banks, an important and problematic objective was to draw “their” companies into the clientele of their mother companies (banks). The conflict of interest is obvious if a bank is (directly or indirectly) both an owner of and a lender to a company. On the one hand, under certain circumstances, it can be in a lender’s best interest to push its debtor into bankruptcy. But an owner would not do that, since it would jeopardise its own equity holding. On the other hand, the banks as owners could not strive consistently to maximise shareholder value, because that would have contradicted the interest that they had as lenders.

Despite these problems, analyses show that bank-related Privatisation Investment Funds, as compared to other PIFs, helped those firms in which they held significant shares to function relatively efficiently (Claessens et al. 1997), although the possibility of a selection bias cannot be excluded: these PIFs had better access to information, and were able to select better companies for shareholding. But on the other hand, this business was certainly not good for the banks’ long-term financial health. In 1997, the share of bad loans was higher in the Czech Republic’s banks than in any other Central European country’s (EBRD 1997). And the non-transparent relationships between the banks and their PIFs had helped cause this unfortunate state of affairs (Cech 2004, EBRD 1998). Banks’ recapitalisation costs, paid from the public purse, exceeded by far the amounts needed in Hungary or Poland, which was obviously not independent of the peculiar role played by Czech banks in the privatisation.⁸

3.3 Primary privatisation—Russia

In Russia, with Gorbachev’s perestroika, enterprise managers began to sporadically appropriate parts of enterprises from 1986 onwards. Private wealth at the expense of state property continued to grow, albeit still very

⁸ “The Czech approach did little to restructure firm–bank relations but fostered an increase in lending in the mid- to late 1990s that ultimately proved unstable” (McDermott 2007, p. 233). Based on the available sources, the author states that during the economic transition, banks’ total recapitalisation costs amounted to 7.4 percent of the GDP in Poland; they were 12.9 and 30.2 percent of the GDP in Hungary and the Czech Republic, respectively.

slowly but on a wider scale, with the exploitation of opportunities created by the Law on Cooperatives of 1988 and, more generally, with the loosening of the strict hierarchy of party-state control (Buiter 2000). But all these—often not very clean—deals were rather small and did not incorporate the privatisation of medium-sized and large firms. However, Russia's "managerial revolution" did not stop at this point. In 1990–1991, medium-sized enterprises sporadically began to become cooperatives; on a wider front, they were leased by their managers and other employees. The initial capital of the financial-industrial groups, tycoon empires of later times, were created in this period (Medova and Tischenko 2006). Many of the deals started in the framework of, or were closely related to, Communist Party or Communist League of Youth (Komsomol) organisations. Among them were the Youth Scientific and Technological Innovation Centres. Establishing such centres at Komsomol organisations was allowed starting in 1986. They could cooperate with state-owned enterprises and exploit their privileges in such cooperation. E.g., they could receive the right to conduct export and import deals autonomously and directly. Ordinary enterprises were deprived of this opportunity (this was called the principle of the foreign trade monopoly of the state). The newly established Youth Scientific and Technological Innovation Centres, despite their name, generally did not care much for science and technology. They used their privileges to make as much money as possible. Khodorkovsky, the well-known oil baron who was incarcerated in 2004, began his business career at one of these centres, called Menatep, established under the aegis of the Communist Party Committee of Moscow's Frunze district.

In parallel with these developments, debates continued over how to privatise. Still in the first half of 1991, the Pavlov government expected significant privatisation revenues for the following years that could reduce the deficit of the state budget, or even restore equilibrium (Clarke 1994), although the laws approved by the Parliament in July already also foresaw voucher privatisation. In August there was a coup d'état to restore the communist system. After its failure, Yeltsin, the recently elected president of Russia, who played a crucial role in defeating the coup, appointed a new government with a strong liberal orientation. Both the president and the government played key roles in preparing for the peaceful dissolution of the Soviet Union at the end of that year. The Russian method of economic reforms, including that of privatisation, was born after this dissolution, in the new, separate (sometimes called "independent") Russia.

In the field of privatisation, the government had to arrive at compromises with several interest groups, which often were in heavy conflict

with one another. The government was also under strong pressure to act rapidly because spontaneous privatisation was underway, reducing privatisable state property. As already mentioned, the Gaidar–Chubais team first wanted to give priority to the sales approach, and later to free distribution among citizens, i.e., voucher mass privatisation. However, sticking to this liberal idea was simply not possible. Concessions to other ideas were the price of any privatisation. As Chubais writes on one concession given to enterprise managers: “at the start we shaped a pattern of privatisation in which the ban to fire the director for one or two years was a basic condition. And what should we have done? Without clauses like that no privatisation would have happened. On the other hand it was clear for us that later the natural process of renewal would work: shareholders [...] would initiate it” (Chubais 1999c, p. 295). Shleifer and Treisman (2000) describe in detail the path on which the government arrived at the solution in which all those important parties that could have blocked the deal received something. Sectoral ministries received the power to veto the privatisation of larger, “strategic” enterprises. Regions (republics, oblasts, krays, and the like) were allowed autonomously to implement small-scale privatisation within their administrative boundaries. They also received 15 to 20 percent of the shares of privatised companies; they could privatise these shares later. And trade unions and enterprise managers received (or, thanks to their strong representation in Parliament, rather snatched) a pattern of privatisation formally based on vouchers distributed to all citizens but still radically different from the one that was seen in Czechoslovakia/the Czech Republic. In this Russian pattern of voucher privatisation, small investors and Privatisation Investment Funds did play a role, but a much more modest one than in the Klaus model. The main beneficiaries of the distribution were insider groups: working non-managerial employees and managers of the privatised companies.

According to the draft law submitted to Parliament in March 1992 (which later became Option 1), employees could receive free of charge 25 percent of the value of their company in the form of non-voting shares. They could buy a further 10 percent of the shares (in this case, voting shares) at a discount of 30 percent (discounted from the already very low price, which was based on the book value of the company). They could buy yet another 10 percent at full price within two years (in usual financial parlance, this would be called an option). Furthermore, management could buy, also at book value, an additional five percent of the shares.

Parliament, whose members were largely enterprise managers and trade union leaders, did not accept this proposal (even though it was al-

ready a compromise from the point of view of the government's neoliberal intents: it was rather "insider-friendly"). One important amendment introduced by Parliament allowed the use of enterprise profits and even revenues from share sales as sources of the payment for insiders' share purchases (Clarke 1994). Besides that, and more importantly, Parliament introduced Option 2. According to Option 2, all employees, including managers, could buy, for vouchers or cash, at 1.7 times book value, 51 percent of the shares (with voting rights), and during a period of two years they could buy another five percent for cash. In Option 1 outsiders held 50 percent of the shares (but, as follows from what was said above, they had a voting majority). In Option 2, insiders could have a clear majority of 51 percent both of shares and voting rights (and, beyond that, the additional five percent that they were entitled to buy within two years could not strengthen the position of outsiders during the option period of two years). Parliament also added a third option to the law, which, however, was almost never applied in practice.⁹

Table 3.3.1 demonstrates that the majority not only of medium-sized enterprises (those employing 200 to 1,000 workers) but also of large ones chose Option 2. Option 1 was basically unavoidable at large companies with high capital intensity, where financing Option 2 was unfeasible. Besides that, enterprise managers also selected this kind of allocation of the shares if they did not want to give their employees shares with voting rights. Table 3.3.1 also shows the low popularity of privatisation via leasing arrangements. However, leasing by non-managerial employees and managers had been rather widespread in 1990–1992, i.e., before mass privatisation, particularly with medium-sized companies. And companies leased then were largely bought, at book values, by the insider groups leasing them in 1993–1995. According to Sprenger (2002), the insider ownership resulting from this privatisation method was even higher than that from the three voucher privatisation options.

In voucher privatisations, the shares beyond those given or sold to non-managerial employees and managers (50, 44 and 40 percent in Options 1, 2 and 3, respectively) were sold to outsider investors, and partly could even be kept in state (regional government) ownership, but 29 percent was

⁹ In Option 3, managers and workers could partly receive and partly purchase for money partly voting and partly non-voting shares of their companies, but not more than 60 percent of the total, partly immediately and partly in a year's time. Shleifer and Treisman (2000) explain this option's unpopularity (which is reflected in Table 3.3.1) as a result of its complicated conditions.

always to be sold (exchanged) for vouchers, in the form of auctions. Each citizen was entitled to receive vouchers valued at 10,000 Russian roubles. At 1992 exchange rates, that might already seem a symbolic amount (the rouble was trading at around 160 to the dollar in August, and around 400 in December). But the book values of enterprises' assets were not adjusted to inflation, and had mostly been set before 1988, when US \$1 nominally equalled 0.9 rouble. Of course, the high purchasing power of the vouchers was guaranteed only for insider buyers of shares, because they could purchase the shares of their companies at prices calculated from the book value of company assets. For outsiders' purchases, auctions were organised. Vouchers could also be spent in small-scale privatisation and could also be sold freely on the market. In these respects, Russian voucher privatisation was different from the Czechoslovak/Czech version.

Table 3.3.1 The distribution of Russian mass-privatised large and medium-sized companies according to the selected option of allocation of the shares

	Large companies	Medium-sized companies	Total
Number of companies	2284 (100%)	8734 (100%)	11018 (100%)
Selected allocation			
Option no. 1	758 (33%)	1551 (18%)	2309 (21%)
Option no. 2	1377 (60%)	6748 (77%)	8125 (74%)
Option no. 3	22 (1%)	83 (1%)	105 (1%)
Leasing	2 (0%)	4 (0%)	6 (0%)
Unknown	125 (5%)	348 (5%)	473 (5%)

Source: Lieberman et al. [1995]

Remark: Medium-sized are companies with 200 to 1000 employees, large are those employing more than 1000

Another feature specific to the Russian privatisation model was the companies' right to autonomously select the concrete method of privatisation: Option 1, 2 or 3. In principle, the workers' collective had the right to decide. In practice, managers decided, except in certain sectors, e.g., the automotive industry, where trade union activity was strong. But basically, managers' and workers' interests were parallel. Option 2 suited both groups because it guaranteed them 51 percent of the votes. In this option, insiders—but in reality, the management—had a supplementary advantage: the company itself could organise and implement the auction of the non-insider portion of its shares (in Option 1 this was the privilege of national or regional privatisation committees). Actual sales were seldom sterling examples of fair play. Insiders sometimes used enterprise assets, and sometimes even budget

money, to acquire shares. At voucher and share auctions, illegal methods were frequently applied in order to exclude outsider bidders (Sprenger 2002). However, illegal methods were largely unnecessary: in practice, managers were assigned to put forth a privatisation plan containing specific investment requirements with which only their affiliated company could comply. Thus insiders were very often behind ostensibly outsider owners (Clarke 1994). But however strong the position of insiders was, it never satisfied Parliament, their political representation. The pressure for an even more insider-oriented method of privatisation was particularly strong at the beginning of 1993, with a plan to increase the proportion of shares given to insiders to 90 percent. This rule would have been introduced in the form of an amendment of the annual privatisation directives, whose draft was withdrawn by the government when the idea was raised. After this, the activities of the State Property Committee (Goskomimushchestvo), the agency implementing privatisation, were guided by presidential decrees.

Privatisation Investment Funds, basically similar to those seen in the Czech Republic, were also established in Russia, and they were as loosely supervised¹⁰ as their Czech counterparts. However, their importance was rather limited (only approximately one-quarter of the vouchers was invested into them) because the majority of enterprise employees used their vouchers in the framework of insider privatisations. Vasiliev, who headed the Federal Securities Supervision at the time, estimated that half of the vouchers went to insider privatisations, and the remaining one-quarter was used for direct purchases of company shares, partly by secondary owners. The latter could accumulate large portfolios of vouchers, using them to purchase (without the mediation of Privatisation Investment Funds) companies that were sometimes quite large. A good example is Oleg Deripaska, who in the mid-1990s became the “king” of the Russian alumina and aluminium industry, and nowadays is a respectable co-investor of large Western businesses in Russia and elsewhere in Europe in a variety of economic sectors. In the winter of 1993, while still a student at a Moscow university, Deripaska had purchased the vouchers of workers loitering around the Sayansk aluminium factory (Lavrentieva 2002).

¹⁰ According to Chubais’ description, the work with the Privatisation Investment Funds consisted of two phases: their establishment and their supervision. “The first phase was so complicated, and required so much effort from us that, having plunged into it and then achieved success, we fell to a kind of euphoria. And we languished. And at some moment the mechanism of supervision of the structure that we had built went out of our sight” (Chubais 1999b, p. 186).

Table 3.3.2 The ownership structure of Russian industrial firms employing more than 15 persons in 1994 (according to the number of firms, in percent)

State property 34	Privatised 66		
	Insiders 55		Outsiders 11
	Managers' property 12	Non-managerial employees' property 43	

Source: Estrin [1996] (on the basis of a World Bank survey)

The ownership structure of industrial enterprises by the most important types of owners (the state–private outsider owners–insiders broken down as managers and non-managerial employees) developed after the first wave of privatisation of 1992–1993 is displayed in Table 3.3.2. The domination by insiders—rightly treated by analysts as the main characteristic of the Russian privatisation (e.g., Sprenger 2002)—is eye-catching. This domination was further strengthened by the frequent occurrence of insider- (usually manager-) owned companies among “outsider” owners. Another factor strengthening insider domination (in another way) was the mostly dispersed character of outsider ownership. All this was reflected in the composition of boards of directors. According to the results of various polls, insider influence often predominated even in the boards of companies whose (formal) owners were primarily outsiders (e.g., Angelucci et al. 2002). In the latter aspect, “insider” meant only managers; non-managerial staff was rarely represented in boards of directors (Blasi and Shleifer 1996).

Russian privatisation policy tried to turn towards sales for cash in 1994. In July a presidential decree ordered that the role of cash payments in privatisations be increased. However, auctions were often not clean, and the measures taken did not do away with the domination of the insiders (Medova and Tischenko 2006). The shift towards privatisation for cash could be explained by two factors. First, speed was no longer the first priority. Privatisation was already beyond the critical mass needed to make this fundamental systemic change irreversible. Second, the repeated acceleration of inflation and the budget deficit required the increase of budget revenues. (One further factor may have been the advancement of Chubais to the post of first deputy prime minister. He kept the main responsibility for privatisation that he may have tried to exploit in his other additional job—managing the federal budget.)

Finding investors willing to pay with cash was not easy, and did not go quickly. Significant successes were achieved only from 1997 on, when the repeated attempt to (partially) sell the telephone company Svyazinvest resulted in the sale of a 25 percent block of shares to a consortium of foreign and Russian investors for US \$1.875 billion. A 2.5 percent stake in the hydrocarbon giant Gazprom was sold to the German Ruhrgas for US \$660 million in December 1998, and already in 1999, stakes in 11 large (mainly oil industry) companies were sold to foreign investors (Appel 2004, p. 103).

However, this cash-sales period of privatisation did not end without a series of preferential privatisation deals—a rather infamous series this time, labelled “loans for shares”. It started in August 1995 with a presidential decree. The shares of 24 large industrial companies—partly natural monopolies in various extractive industries and telecommunications—were transferred to the custody of some “financial-industrial groups” (Inkombank Group, Most-Bank Group, SBS-Agro Group, Oneximbank Group, Menatep Bank Group, Rossiyskiy Kredit Group and others) headed by oligarchs as collaterals for loans totalling US \$1.2 billion granted to the Treasury. If the loans were not repaid, these groups would become actual owners of those 24 companies—and this is how the deal ended. The actual value of the companies was estimated at US \$25 billion (Medova and Tischenko 2006, Sprenger 2000).

3.4 Primary privatisation—Ukraine

Privatisation in Ukraine was dominated, even more than in Russia, by enterprise managers in the period analysed in this book (Frydman et al. 1993, Krakovsky 2000). The first privatisation model was built on leasing. Leasing deals set at the end of the Soviet period were “inherited” by independent Ukraine, and in 1992 a new law further stimulated such arrangements. Namely, for new leasing ventures (which enterprise collectives could start without any competitive bidding), the annual fee was fixed at five percent of the previous year’s wages and profit. Furthermore, this leasing fee was not adjusted to the rather rapid inflation. And lessees could buy their company under very advantageous conditions. At the end of 1992, already one fifth of state-owned companies were being leased (Frydman et al. 1993). Of course, primarily good companies were leased (Kyryliuk and Leshchenko 2000). However, the policy changed in 1995. From that year on, new privatisation leasing could not be started (Snelbecker 1995).

The basic legal framework for privatisation was already established in 1992. However, even the auction-based small-scale privatisation progressed very slowly, and privatisation beyond that was restricted to the already mentioned leasing. More progress was blocked by a quarrel between government and Parliament: the scope of privatisable firms had to be determined by the programme of privatisation that Parliament failed to approve until Kuchma was elected president. However, besides the leasing, mechanisms of spontaneous privatisation also worked. By mid-1994, 3,000 of the 18,000 medium-sized and large companies that Ukraine had at independence, and 10,000 of the 45,000 small companies, were “privatised”. This partly meant their purchase by their managers and non-managerial employees, but partly was restricted to their corporatisation. Outsiders’ stakes in companies that had actually been transferred into private hands were only 20 percent (Drum 1997).

The privatisation of small companies accelerated in the second half of 1994, but the debate on the privatisation of large companies continued. The contours of the agreement on the latter were shaped by the end of the year, but conflicts between the President and Parliament continued to hinder the process. (Sometimes the opposite happened: conflicts accelerated privatisation. For example, several times in 1995–1996, the president vetoed a law forbidding the privatisation of agro-industrial enterprises. When he finally signed the last version of the law, the privatisation of some of the enterprises concerned—which was urgent for their managers—already happened [Drum 1997]). Parliament forbade the privatisation of “strategic” companies in 1994. (Companies in monopoly positions and those with at least 35 percent positions in their market were considered “strategic”.) Only in 1999 was the privatisation of 50 percent, or in some cases 75 percent, of their shares allowed (Grygorenko and Lutz 2007). Besides Parliament, privatisation was also hindered by sectoral ministries and some regional governments. The political struggles surrounding privatisation were also reflected by never-ending administrative reorganisations: between 1992 and 1998, authority over the privatisation agency went back and forth three times between Parliament and the government (Pashkaver 2000).

Voucher mass privatisation did not bypass Ukraine. By the end of 1996, 80 percent of citizens collected their privatisation vouchers (which were issued in the value of approximately US \$250 for every adult citizen; their value was indexed to inflation several times). Vouchers could be used to purchase the shares of medium-sized and large companies. Citizens were not allowed to sell their vouchers: they had to exchange them

for company shares at privatisations or for shares of financial intermediaries (Privatisation Investment Funds, PIFs) which themselves were buying shares at privatisations. (However, they could sell the shares not only of the privatised companies but also those of the PIFs if they had invested their vouchers into PIFs [Krakovsky 2000]).

Voucher exchanges at privatisations were organised in the form of auctions, but enterprise employees' vouchers were exchanged for shares at prices based on book values of their companies. They were also entitled to buy (for cash) another portion of about US \$130 of the shares of their enterprises, at the same prices. Thus, and also taking into consideration the supplementary preferential purchasing possibilities of enterprise managers discussed below, companies with a share capital not exceeding some US \$400 per employee could easily be purchased by insiders (Snelbecker 1995). Enterprise managers could buy five percent of their company at book value and—as remuneration for helping prepare the privatisation—an extra five percent. (The additional five percent was introduced only in 1996; before that managers often hindered the privatisation of the larger, more capital intensive companies [Drum 1997, Estrin and Rosevear 2003]). As concerns the auctions of enterprise shares to outsiders, for vouchers or cash, insufficient demand often caused problems. Auction rules did not allow shares to be sold below book value, thus preventing sales. Because such cases were not rare, the process was slow (Snelbecker 1995). After the preferential purchases by enterprise managers and workers at the auctions, on average 30 percent of the enterprises' shares remained in the hands of the State Property Fund (Drum 1997), and many of these shares were not sold even at the end of the 1990s (Grygorenko and Lutz 2007). Unsold shares strengthened the positions of enterprise managers because they usually received voting rights based on these shares (Estrin and Rosevear 2003).

As concerns Privatisation Investment Funds, the State Property Fund licensed more than 350 PIFs for participation in voucher privatisation. They were allowed to buy up to 25 percent of the shares of any single company and to invest into it up to five percent of their capital. Approximately 30–40 PIFs held 80 percent of the capital of all PIFs. PIFs exchanged 85 percent of all non-insider vouchers to shares in the first five years of voucher privatisation. Later, when privatisation caught the population's fancy, this proportion diminished and individual investors' direct participation increased (Drum 1997). Funds showed little interest in managing the companies whose shares they held; they saw their job as trading the shares (Estrin and Rosevear 2003). In the first years, foreign-

ers were allowed to participate in privatisation only under a special arrangement. Namely, they had to pay for such activity with Ukrainian hryvni that they purchased at a specific (worse) exchange rate (Pashkaver 2000).

As for the achieved level of privatisation, the share of GDP produced in the private sector was 60 percent in the year 2000 in Ukraine, less than in any of the other five countries in this analysis (see Table 3.4.1). There is little additional data useful for characterising the extent of privatisation, because most authors studying the issue have trouble deciphering the data, treating small, medium-sized and large companies sometimes together, sometimes separately. A study prepared by the experts of the International Monetary Fund sets at 1,240 the number of companies purchased through leasing agreements in the first phase of privatisation and the number of those privatised in the second, voucher-based phase between 1995 and 1998 at 9,240 (Elborgh-Wotek and Lewis 2002). After 5,500 to 7,000 voucher exchange auctions carried out annually between 1996 and 1998, only 212 were carried out in 1999 (Bleyzer et al. 2003).

The third phase of privatisation was announced in 1998, when the significant sale of strategic firms started, via tenders and stock market initial private offerings. In that year only seven electric energy companies were sold, but in 1999–2001 several important privatisations were implemented in the fields of energy, telecommunications and metallurgy. Privatisation revenues increased from 0.3 billion hryvni in 1998 to 2.0 billion, both in 2000 and in 2001 (thus totalling in these two years more than US \$0.8 billion) (Elborgh-Wotek and Lewis 2002).

As for corporate governance problems, i.e., abuses at the expense of minority shareholders, their presence is demonstrated by the above-mentioned difficulties faced at share auctions for non-insider voucher-holders. Corporate governance problems must have been partly responsible for the lack of demand that often thwarted such tenders. Nevertheless, Ukraine did have a certain advantage in this respect over other countries (notably the Czech Republic and Russia) that implemented mass privatisation programmes earlier. Ukraine was able to learn from its mistakes, and more easily found its way to the necessary regulations and enforcement institutions. For example, in Russia the obligation of companies to keep their share register at an institution independent of them was ordered only in 1996, when voucher privatisation was already finished. In Ukraine, interim share registers were established in voucher auction centres even at the beginning of voucher privatisation, and the establishment of private-sector share register centres was also stimulated in due time (Drum 1997).

Table 3.4.1 The contribution of the private sector to the production of the GDP in the six countries

Country	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
Czech R.	10	15	30	45	65	70	75	75	75	80	80	80	80	80
Hungary	25	30	40	50	55	60	70	75	80	80	80	80	80	80
Poland	30	40	45	50	55	60	60	65	65	65	70	75	75	75
Slovenia	15	20	30	40	45	50	55	60	60	60	65	65	65	65
Russia	5	5	25	40	50	55	60	70	70	70	70	70	70	70
Ukraine	10	10	10	15	40	45	50	55	55	55	60	60	65	65

Source: European Bank for Reconstruction and Development

However, enforcing the laws and regulations did not go smoothly, and the predominant ownership positions of insider managers–workers groups resulted in widespread abuses of the rights of outsider shareholders, as well as the (shareholder) rights of the workers, just as in Russia (Bleyzer et al. 2003, Krakovsky 2000, Estrin and Rosevear 2003).

3.5 Primary privatisation—Poland

Distribution among citizens had to be one of the main methods of privatisation in Poland—this was decided as early as 1990–1991 and was even included in the 1991 law on privatisation, following the initiative of Deputy Prime Minister and Minister of Finance Balcerowicz, who played a key role in the management of the Polish economy in the first non-communist governments. Practical implementation was, however, delayed, because priority was given to macroeconomic stabilisation. And then the postponement became much longer than intended (Goldman 1999), basically because of the lengthy debates on the patterns and priorities of privatisation (e.g., Lewandowski 1997, Baltowski 1998). Nevertheless, the share of the private sector in the economy was not growing much slower (from a relatively high initial level) than in some other, (ostensibly) less hesitant countries. Even though in the mid-1990s, Poland lagged in this respect vis-à-vis the Czech Republic, Hungary and Russia, the lag was small (see Table 3.4.1). The explanation for these diverging indicators is the fact that privatisation started, already in 1990, with other, non-voucher methods. These were privatisation by liquidation, later called “direct” privatisation, or alternately, “capital” or “indirect” privatisation. (Both of these methods were included in the 1991 privatisation law.)

Privatisation by liquidation or, as it was later called, direct privatisation was direct because it was not preceded by the corporatisation of the firm concerned. Instead, the latter was liquidated—it ceased as a legal entity. By law, this could be done upon the request of a limited liability company established by at least half of the employees, even if the firm was not bankrupt. Then the firm was leased to the company, and with the expiration of the leasing contract it became the company’s property. Of course, workers and managers did not initiate such ventures with firms that were economically weak (or required important investments) (e.g., Mikolajczyk and Roberts 2006), because they had no other way to pay the leasing fee than from the firm’s profit (the part of the profit covering the leasing fee was tax exempt). But of course, this privatisation pattern was

very popular with profitable firms, and it was applied to half of all privatisation deals carried out by 1998. This kind of “slaughtering” of non-bankrupt enterprises to the working collective’s liking can be explained partly by the recent self-management experience: from the early 1980s, workers’ councils played an increasing role in the management of Polish enterprises. And proposals flourished for the introduction of workers’ ownership of state-owned firms (e.g., Krawczyk 1988, Jasinski 1994).

Beyond that, and more importantly, *Solidarność* and other trade unions also supported privatisation aiming at workers’ ownership rights. Essentially, the whole strength of efforts for insider privatisations was based on the (then already ten-year-old) struggle of *Solidarność* against the communist dictatorship. At the round-table negotiations, which established the basic framework of the transition from dictatorship to a liberal multi-party democracy, *Solidarność* led (and largely constituted) the non-communist side. Balcerowicz, who was minister of finance in the transitional government formed after the negotiations and then in later governments until 1993, received his legitimacy from *Solidarność*. As a liberal economist, he opposed the development of an insider-based ownership structure of formerly state-owned companies. However, unlike his Czech colleagues, his hopes for success in the debate with the proponents of insider privatisation, particularly with *Solidarność* activists, were rather limited. Besides that, Polish enterprise managers, who were as keen on insider privatisation as their Czech counterparts, were more efficient adversaries than those Czechs, because they were more technocratically minded, and politics played less of a role in their appointments. (But of course, their power was much more restricted than that of the Russian managerial elite whose communist party relations—and without much exaggeration, communist party origins—were an advantage, rather than a disadvantage. This issue is examined further in Sections 6.3 and 6.4.) In the first years, the insider ownership of firms privatised by liquidation was also protected by the quasi-monopolistic position of the insider owners because they were usually the sole or the predominant owners. In the (weighted) average of a sample of 110 firms analysed by Kozarzewski and Woodward (2001), the share of ownership by other Polish firms and foreign physical persons or legal entities was only 7.6 percent. At the same time, the average share of the firms’ managers was 33.7 percent and that of non-manager workers 58.7 percent. The managers’ share was significantly higher—41.0 percent—and, mirroring this, that of non-manager workers was lower, 51 percent in the unweighted average, suggesting that managerial ownership tended to be larger in smaller companies.

Direct privatisation was also possible without the proposal of the working collective, but only for bankrupt companies. Then (if there were not more than 300 employees) the company's assets were sold, through accelerated tender or negotiations, to the domestic private sector. But the Treasury could also utilise the assets of such a company by contributing them to a joint venture established with a private investor. Yet another method of privatisation (although formally not considered as such) was the actual liquidation of bankrupt companies through a normal court procedure and also the restructuring of companies by banks (obviously, of companies highly indebted to banks) (Mickiewicz and Baltowski 2003, Kozarzewski and Woodward 2001).

Indirect privatisation began with the corporatisation of the company concerned; then it could be sold. When the company became a corporation, its workers' council was liquidated (but a third of the members of the board of directors were elected by the employees). The protection of workers' interests was served by the rule that if the corporatisation was not initiated with the consensus of the director and the workers' council, then only the prime minister had the power to approve it (rather than the minister of privatisation). Workers had the right to buy 20 percent (after 1996, 15 percent) of the shares. The remaining shares were auctioned or sold in simplified tenders at medium-sized companies. At large companies these shares were tendered, i.e., potential buyers had to compete with each other in several dimensions. Thus, besides the price that they were ready to pay for the shares (which gave them a comfortable majority of the votes), they also had to take investment, employment and possibly some other commitments. In other cases, the remaining shares were sold at the stock exchange. (Until 2001, the Polish state sold company shares 56 times at the stock exchange, but not all these sales were IPOs, i.e., for some—very large—companies the sale was performed in several phases [Mickiewicz and Baltowski 2003, Privatizationbarometer]).

According to Mickiewicz and Baltowski (2003), there were more than 8,500 state-owned enterprises in mid-1990, a number that fell to 1610 by mid-1999. Another 759 were undergoing bankruptcy procedures, and 570 were corporatised but not privatised. In all, a quarter of the original 8,500 enterprises were still state-owned.

On the other hand, privatisation was carried out or at least began at more than 6,500 companies. Of these, 612 were under (genuine) liquidation, and another 729 had already been liquidated. Six hundred and forty-five companies were involved in the direct privatisation programme; another 1,575 companies had already been privatised in this way (two-thirds

by employee leasing). All 1,662 state farms were liquidated by 1995; property and land were sold or leased. A total of 1,399 companies were corporatised and privatised; of which 512, representing some 10 percent of total privatised enterprise value, were included in the voucher (mass) privatisation programme (Baltowski and Mickiewicz 2000).

Voucher privatisation was prepared by the liberal Minister of Privatisation Lewandowski, but its processes were subject to rather detailed and strict rules, unlike what we have seen in the Czech and Russian cases. Comparing the Polish solution with the latter two, Goldman (1999) describes it as a model of good regulation. Working out the programme's details took a long time, mainly because of political debates (the separate law on voucher privatisation should have been created soon after the basic privatisation law of 1991, but Parliament did not approve it until 1994). Not everything was different from the Czech model: in compiling the list of companies included in the programme, some negative selection also occurred in Poland. (Towards the end of the preparatory work, obviously with the aim of increasing privatisation revenue, 30 companies were removed from the programme and replaced by 101 others in worse condition (Duvivier [1997].) The majority of the companies belonged to processing industries (including food processing) and the building trade, but some wholesale and retail trade and transport companies were also included.

The workers of the 512 companies selected received 15 percent of their companies' shares. Twenty-five percent was held (temporarily) by the state Treasury. The remaining 60 percent was distributed among 15 National Investment Funds (NIFs), in two waves, in July and December 1995. Thirty-three percent of the shares of each company were allocated to one of the NIFs as a main shareholder, and 27 percent were distributed among the other 14 NIFs. Each NIF received shares totalling approximately US \$100 million.

The NIFs were established in the form of public limited companies. Thus they were similar to closed-ended funds in the sense that their investors could only sell their shares to third parties (this issue was discussed in some detail in subsection 3.2). However, unlike their Czech, Russian and Ukrainian counterparts, they could also play the role of holding companies. They were not restricted to owning only 20 percent of the shares of one company. From the start, each NIF had a 33 percent share in more than 30 companies, and they were even allowed to become majority shareholders.

The programme attributed great importance to the NIFs' professional management. Although the NIFs had their supervisory boards and boards

of directors (corresponding to the German corporate governance model), the government urged them to engage external management firms in order to achieve better performance. NIFs could select a management firm from a list determined by the government in a tender. The list included mostly foreign investment banks and other similar institutions of good reputation. Fourteen of the 15 NIFs did select a management firm; only one opted for “self-management” (Błaszczuk et al. 2001 and Duvivier 1997).

Every adult citizen was entitled to buy a privatisation voucher for 20 złoty (approximately US \$6)—and 96 percent of them (25.9 million people) did. The voucher could be sold freely; its market value fluctuated at around four to six times its nominal value. Institutional investors accumulated large portfolios, and about 40 percent of the vouchers were bought by foreigners. Each voucher could be exchanged for a package of one share in all NIFs (from July 1997 to December 1998). With this voucher, holders became the owners of 85 percent of the shares of the NIFs.

Subsection 4.2 addresses some issues of the NIFs’ management of the companies. As for corporate governance problems, of course, this rigorously regulated and monitored model of voucher privatisation did not lead to a series of scandals like those in the Czech Republic, Russia and Ukraine. But it was also problematic in its own way. First, there were unclear and overlapping competences, particularly in the first phase of the NIFs’ existence, when they were owned exclusively by the state, and in the second, transitional phase, from July 1997 to late 1998, when the state’s share was diminishing but still high:

“The division of tasks, rights and obligations among the three management organs (management boards, supervisory boards, and contracted management firms) and the relations between them and the State Treasury have been unclear from the beginning. There was a confusing combination of subordinate and superior roles of the management firms in this system, but the main difficulties resulted from the ambiguous position of supervisory boards, which acted both as corporate management organs on the one hand and government representatives on the other. Additionally, the members of the NIFs’ supervisory boards often tried to interfere in the day-to-day management of the funds. The State Treasury, in turn, was very active in influencing all participants in the early stages of the NIF Program (using both direct and indirect means for exercising such influence).” (Błaszczuk et al. 2001, p. 43. The problems of uncertainties of competences are also discussed by Duvivier [1997] and Koladkiewicz [2002]).

On the other hand, the NIFs took sizable management fees, and within them, the non-performance-dependent share was too high. As the propor-

tion of privately owned stocks of the NIFs increased, purchases of significant portfolios of their stocks became possible. The investor who thus accumulated sufficient voting power at a NIF could substitute its own management firm for the former one and thus earn the management fee. The sum of the latter became even higher than forecasted. By the end of 2000—i.e., well before the planned end of the programme in 2005—it reached 756 million zloty (almost US \$200 million), then (following a significant drop in NIF share values) amounting to 42.4 percent of the NIFs' total capital value (Błaszczuk et al. 2001).

3.6 Primary privatisation—Slovenia

The privatisation in Slovenia began with the sale of some bankrupt companies to investors. However, this practice was discontinued in 1993 when, with the improvement of the economic and fiscal situation, the subsidising of weak companies—and more generally, the development of a slow, gradualist strategy of transition to the market economy—became possible. The debates on the privatisation of (stronger) enterprises were lengthy. The final solution was the distribution of their shares among their employees and Slovenian citizens, with priority given to employees, i.e., similarly to Russia and Ukraine and unlike the Czech Republic. In the latter, enterprises had been in a (rather vaguely formulated) “social”, rather than state, ownership in the former (Yugoslav) self-management system, meaning that employees were also among the owners. The role of domestic strategic investors (and that of foreigners even more) remained rather limited.

“Strategic” sectors—energy companies, most subsectors of transport, the post, telecommunications, water-supply, communal services, mining and metallurgy companies, two large banks and several insurance companies—were nationalised (i.e., taken into state property) and, before 2000, not privatised. Besides that, a series of enterprises working with losses were nationalised, too. (Although Slovenia was only marginally affected by the wars related to the disintegration of Yugoslavia [see subsection 6.3.1 for more detail], its economy was severely damaged by the loss of the market of other former Yugoslav republics.) Technically, the nationalisation of the enterprises, carried out in 1992, meant the liquidation of their self-management organs and their subordination to the Slovenian Development Fund. The Fund's task was their corporatisation, their pre-privatisation restructuring and then their privatisation. The Fund had to

implement the rather limited restructuring of the enterprises with minimal input, for instance, by making advantageous arrangements with the creditors. It even did not have to avoid layoffs that were necessary to make the enterprises viable. (But workers would have received, free of charge or under preferential conditions, 20 percent of the enterprises' shares.) Participation in the programme was based on voluntary application. Half of the applicants, 98 enterprises (together with their satellite units making up 250 entities) were accepted, employing 56,000 workers, or 10 percent of employees of the enterprise sector.

According to the estimates of independent experts, a quarter of the workers should have been fired. This would have cost the state treasury a great deal in severance pay. And ridding the enterprises of their debts was also difficult, because the restructuring of the banks started simultaneously. Their bad assets were transferred to the Bank Rehabilitation Agency, and the latter was legally obligated to maximise the proceeds from the collection on those bad assets so as to minimise the public debt burden (Simoneti et al. 2004). The enterprises should have been privatised, or if that was impossible, liquidated within two years. However, the firms' sale was hindered by the firms themselves: both their workers and managers were afraid of professional private owners. Besides that, foreign interest in the enterprises was feeble, and there were hardly any domestic investors able to provide the capital needed for their effective restructuring. The staff of the enterprises was reduced by 20 percent, settlements were agreed upon with the creditors of half of the enterprises, and 30 of the 98 were sold within the two years deadline. But from 1993 on, with the improvement of the economic and fiscal situation, the initial intentions were given up. The Fund was transformed into a corporate entity (Slovenian Development Corporation, SDC), and keeping alive its remaining companies became its new task. With its accession to the European Union in May 1994, Slovenia had to apply the *Acquis communautaire's* strict rules on public subsidies to businesses. The SDC's activities would have violated the rules. To avoid that, the SDC was liquidated in 2002. The shares of its enterprises were exchanged for privatisation vouchers of Privatisation Investment Funds.

Of course, the privatisation of "normal", non-bankrupt enterprises offered a wider range of alternatives, and became a hotly debated issue, as several competing proposals emerged. One "decentralised" solution would have trusted each company's main stakeholders (managers, lenders, non-managerial employees and potential buyers) with finding the particular way to privatise it, with the application of various selling techniques and

limited free distribution of shares only to non-managerial employees, not to citizens. Government bodies would only have supervised the process. Another study urged a diametrically different, highly centralised model, essentially along the lines followed by the Polish voucher privatisation. This would have meant a radical break with the self-management tradition (or more precisely, with its recently reborn, genuine decentralising tendency).

Zapp (1996) gives a detailed description of the debate. But while the debate was going on, enterprise managers did not remain passive: “spontaneous privatisation” appeared in Slovenia too. Parts of enterprises were transformed into corporate entities, and abuses did occur in this process (as in the other countries in this study). To prevent the abuses, Bajt (1992) proposed the recognition of the property rights of enterprise non-managerial employees and managers over their enterprises. It should be noted that Bajt was the most influential Slovene economist, with no less liberal views than the proponents of voucher privatisation plans in the Czech Republic and Russia. The weak “marketability” of radical liberalism in Slovenia can best be illustrated by the fact that Bajt saw the least conflict-generating and least damaging way towards the development of a “normal” capitalist system in such an insider pattern of privatisation.

The Ownership Transformation Act was passed by the legislature in November 1992, after two years of debate, the resignation of several ministers, and, ultimately, the fall of the government over the issue. It was largely insider-oriented, but it also distributed shares to citizens; additionally, it envisaged the application of traditional privatisation techniques. The process was supervised by the Agency for Restructuring and Privatisation. Within six years, 1,381 enterprises were corporatised and privatised (and another 55 were transferred to the Slovenian Development Corporation or liquidated).¹¹ (Thus the total was 1,436. Another source [World Bank 1999b] sets the number at close to 1,500.)

Privatisation was based partly on vouchers distributed among citizens. Citizens received vouchers valued at US \$1,500–3,000, more than in any other mass privatisation; the exact amount was determined by age (older citizens were entitled to more vouchers). They could exchange them for stocks of their own or other companies or for the stocks of Privatisation Investment Funds (PIFs). Selling the vouchers was not allowed, but the stocks purchased with them could be sold. PIFs were established by the

¹¹ The basic source of this description of the Slovenian Development Corporation, the preparations for privatisation and the privatisation law is Simoneti et al. (2004).

private sector (but also by state-owned banks). They were not allowed to invest more than 10 percent of their assets into any single company. At the same time, their stake in companies was not limited, meaning that they could be not only financial but also strategic investors. Privatisation Investment Funds were obliged to contract management firms for the professional administration of their portfolios. At the end of 1995, 14 management firms controlled 81 PIFs; the number of PIFs fell to 72 by mid-1997. Sixty-two percent of the initial capital of PIFs and management firms was advanced by banks and insurance companies (which in that period were almost exclusively state-owned).

Companies' stocks at privatisation were allocated as follows. Forty percent was transferred to the state funds. Within this, 10 percent was given to the Pension Fund, another 10 percent to the Compensation Fund (for compensations related to properties confiscated under communism) and 20 percent (or, as will be seen below, more) to the Slovenian Development Corporation. The SDC exchanged these stocks with Privatisation Investment Funds for the privatisation vouchers collected by the PIFs from citizens.

Non-managerial employees and managers, former employees and their family members could receive 20 of the remaining 60 percent of the stocks for their privatisation vouchers. But beyond that, they also could buy the other 40 percent, or a part of it, on credit, depending on the decision of the Workers' Council. For all practical purposes, this was the Council's last decision. With the privatisation, it was liquidated (but workers' representatives became members of the Boards of Directors of companies). Stocks received by employees and their family members could not be sold for two years (and those bought on credit could not be sold for the duration of the credit, i.e., up to five years). What remained after all this was sold for vouchers or cash to small (financial) or strategic investors. The Slovenian Development Corporation received the sales revenue and the unsold stocks.

Ninety-one percent of the firms opted for an at least partial sale to insiders ("self-purchase"). According to what was said above, this meant an ownership share of non-managerial employees and managers exceeding 20 percent. But of course, no firm's insiders "stopped" below 25 percent—this share assured veto rights at important decisions at shareholders' meetings. Twenty-five percent of all the privatised property was transferred by the SDC to PIFs (for vouchers). The Pension Fund and the Compensation Fund became owners of 22 percent; non-insider private domestic (small or large, i.e., financial and strategic) investors purchased

12 percent and foreigners 1 percent. Insiders (workers and managers, former workers and managers and their family members) became owners of an average 40 percent. Not surprisingly, smaller companies and those with low capital intensity became to a rather large extent insider-owned. In 802 companies (61.3 percent of the total) they owned the majority of the stocks. These companies employed 45.7 percent of all workers but their share in the total capital was only 22.9 percent. This group of companies was called “insider privatised”. Within the other group of companies, there were two variants. If the company was introduced to the stock market (i.e., if it became a public limited company), its privatisation was labelled “public”. If it was not introduced, it was subject to “privatisation to outsiders”. Of course, ownership concentration was low at insider-privatised companies. But concentration was mostly also rather low at companies privatised publicly or to outsiders. Usually, the Pension Fund and the Compensation Fund were the major owners, but (as follows from what was said above) their combined proportion was far below 50 percent. Privatisation Investment Funds also often became significant owners. The participation of foreigners was restricted by the Ownership Transformation Act. Purchases of more than US \$10 million in stocks, and purchases of any stocks of privatised companies within three years of the act’s taking effect, were subject to government approval. Thus, at the end of voucher privatisation (and thanks to more liberally treated greenfield investments), only six percent of all company assets were owned by companies with foreign ownership participation; these companies employed 8 percent of all workers (Pahor et al. 2004, Simoneti and Gregorič 2004, Damijan et al. 2004, World Bank 1999b, Simoneti et al. 2004).

Publicly privatised companies had to be introduced on the stock market within two months after the distribution of the shares. However, within this deadline they could hold a shareholders’ meeting and decide to cancel the introduction. The number of companies quoted at the stock market was only 85 in 1997 and 92 in 1998 (Berglöf and Pajuste 2003).

Secondary privatisation in (essentially only) five countries

As Myant (2001) writes, supporters of voucher mass privatisation in the Czech Republic expected that the two waves of the allocation of enterprise shares would be followed by a third wave during which the new owners (the voucher owners turned small shareholders) would “vanish like ... brontosaurus”. The term used in the Polish privatisation literature for this vanishing process is “secondary privatisation”. It cannot be precisely defined, but it refers to the termination of the highly dispersed ownership structure of company stocks that resulted from primary privatisation. Ending this structure, in other words, meant “unburdening” the citizens and/or the non-managerial personnel of companies from the property that they received (purchased under highly preferential circumstances) during voucher and/or insider privatisation.

The supporters of mass privatisation have a valid point. The highly dispersed ownership of the shares could not last; it was not adequate to the circumstances in these countries in the time of privatisation—it was burdensome. Why?

Concerning the shareholdings of citizens resulting from voucher privatisations, the answer is fairly simple. First, most citizens had no experience and very limited knowledge of what being a small shareholder meant. Rather than being shareholders, they wanted to increase their consumption (of course, partly via investments; not so much investments into securities but primarily into cars and the like, serving consumption more directly). Remember that in the Czech Republic, the country with the strongest capitalist traditions, the majority of citizens did not purchase the vouchers to which they were entitled until some Privatisation Investment Funds collecting these vouchers promised up to tenfold yields on them within one year (see subsection 3.2).

Second, those who nevertheless wanted to become small shareholders learned quickly that the circumstances were not good. What was required

was well-functioning, liquid stock exchanges, which did not exist at the beginning of the transition. Also needed were laws and/or codes of behaviour defending shareholders' rights and interests, and just as importantly, well-functioning mechanisms of enforcement of the laws/codes. All this could not be established quickly, particularly if efforts to do so were weak (as they were among the countries studied, particularly in the Czech Republic, Russia and Ukraine, primarily in the first years of transition).¹ (Below we will re-examine in more detail the differences of corporate governance from country to country.) In international literature it is a commonplace that under such circumstances small shareholders—if they exist at all—try to get rid of what they own. Until they do so en masse, this kind of ownership is burdensome.

The position of small insider owners, i.e., non-manager employees who became shareholders, was another, much more complicated issue. The reason for this is that they were basically not financial investors. In principle, their positions as owners gave them some opportunity to control the firms where they as workers earned their living. Still, in the countries studied “there has also been a clear tendency for the share of employee ownership to decline, as lots of workers have sold their shares in the meantime, most frequently to managers but also to external owners” (Lowitzsch et al. 2006, p. 300). This is discussed further below.

Of course, weaknesses of corporate governance had a role here, too—as did the sales of stocks received by people in voucher privatisations. This can be understood better by briefly comparing the United States and

¹ According to Pistor (2000), among the countries implementing mass privatisation, in 1992 the Czech Republic and Russia had the weakest protection of small shareholders' rights. It is also important that in other countries (in all other former communist countries, not only those investigated in this book), voucher privatisation started later than in these two, leaving time to improve the system of protection, and it did improve everywhere (except in Azerbaijan, where it worsened). Improvement could also be observed in Russia, but not (until 1999) in the Czech Republic. Keeping all this in mind, we may consider another, related problem irrelevant: namely, the enforcement mechanisms in question are expensive. (This holds not only for the supervision by government bodies and procedures of justice but also for internal supervision procedures of the companies themselves.) Thus, applying these mechanisms is not rewarding at medium-sized firms; consequently, in advanced market economies usually only shares of large companies are traded at stock exchanges. However, in the countries studied (of course, with the exception of Hungary), voucher privatisation also turned many medium-sized companies into public limited corporations, traded at stock markets. These companies could not have lasted in the long term, even if their countries had had impeccable systems for protecting minority shareholders' rights.

the countries of Western Europe. Workers' share ownership is supported both by socialist movements and government measures conferring tax or other advantages on companies (part-)owned by their workers. Furthermore, employee ownership is fairly popular in the United States, more so than in other Western industrial countries. At the same time, however, neither the government support for employee ownership nor the support of socialist movements for it, is strongest in the United States. Thus the high popularity (meaning the widespread application) of employee ownership in the United States can be explained by its highly developed corporate governance system: better laws and stricter enforcement than those prevailing elsewhere (O'Reilly 1996). However, it should be stressed that employee ownership is also rather widespread in all advanced European countries, including those that only weakly protect the rights and interests of minority shareholders. (At the end of the 1990s, there were employee ownership programmes in all the [then 15] member states of the European Union, except for Austria. The share of companies part-owned by their [non-manager] employees was one percent in Portugal, two in France and Italy, 18 in Great Britain, and between four and 13 percent in the remaining countries [Pendleton et al. 2001]). The very high proportion of such companies in Belgium, 10 percent, is particularly eye-catching, considering that the legal system there is of French origin, and so does not protect shareholders' rights nearly as much as legal systems of Anglo-Saxon, German or Swedish origin (Djankov et al. 2005). This implies that the weakness of small shareholders' rights in the countries studied could not alone explain why employee ownership after insider privatisations was burdensome and inadequate to the (other) conditions prevailing. The missing part of the explanation is that in these countries employee ownership did not have the support usually provided in Western countries. Government support consisted only of words; the institutions necessary for its effectiveness were not established. Enterprise managers supported it more or less—as will be seen later, employee ownership served their interest quite well, though usually only temporarily. At the same time, managers often saw better alternatives for themselves. For example, in Hungary, where many managers had already participated in crossborder economic activities, they often thought (usually with good reason) that their positions could (also) be reinforced under a foreign strategic owner; thus they had little reason to be enthusiastic about employee ownership. Also missing were the social organisations and business firms that usually help introduce employee ownership at interested companies and support their smooth operation. Under such circumstances, employee ownership,

however popular it was in the society as a whole (it was in Hungary—see subsection 3.1), was rarely opted for by the enterprises concerned (as was the case in Hungary), and had to disappear sooner or later in all the countries studied (except in the Czech Republic, where it was virtually non-existent).

Among the forms of government support for employee stock ownership, preferential tax treatment plays what is probably the most important role. In the United States, the first tax benefit for employee share ownership was introduced in 1974. The Employee Retirement Income Security Act (ERISA) gave such support to employee share ownership programmes (ESOPs). Furthermore, 401(k) employees' savings plans, also created in the 1970s and also supported by tax benefits, often represent another form of workers' investments into the companies employing them (although 401[k] savings are not always invested into the shares of the employer). Employee share ownership became popular and widespread in the United States after the introduction of these tax benefits. At 1,000 of the 7,000 companies quoted on various stock exchanges, the proportion of shares owned by (non-manager) employees exceeded 4 percent at the end of the 1990s (Blasi et al. 1994). Further tax benefits eased borrowing for ESOP programmes. The particular forms of preferential tax treatment changed over time, but the basic principle of applying preferences has remained intact (e.g., Blair and Kruse 1999). Tax benefits related to ESOPs are widespread in other Western countries, too; some countries also apply other benefits. For example, in Ireland, with privatisations of state-owned companies, shares are distributed to employees free of charge (Pendleton et al. 2001). No common rules have been established for employee share ownership in the European Union. But the importance of employee ownership is often stressed in various documents—e.g., in the authoritative annual Broad Economic Policy Guidelines of the Council of Ministers of Economy and Finance (ECOFIN)—and this strengthens the positions of groups lobbying for better taxation and other conditions of ESOP companies in the member states.

Such lobbying groups play important roles in most Western countries. For example, the three-decade-old ESOP Association (www.esopassociation.org) in the United States forms coalitions with other interested, authoritative organisations in order to improve the fiscal conditions for new ESOP initiatives. In the United Kingdom, the Employee Share Ownership Centre (www.hurlstons.com/esop), established in 1988, is partly also a lobbying group but, additionally, plays an important role by advising the interested parties on new ESOP initiatives.

The role of trade unions is particularly important in promoting and assisting ESOPs. At the very beginning, unions opposed such initiatives, but from the 1980s on they have increasingly supported them, and even assumed the role of leaders, often negotiating the conditions of ESOP initiatives with company management (e.g., Bell and Neumark 1993, Eiger 1985).

Company owners and managers in Western countries also often support and even initiate employee share ownership schemes. During temporary business slowdowns, companies are under pressure to reduce employees' wages and other benefits. They can do so more easily if, in exchange, they establish a mechanism assuring employees a fair share of their company's future profits. Employee share ownership is one such mechanism. In other cases an employee share ownership programme can help the company by generating fresh capital for it (if employees buy the stocks on bank credit). Additionally, the change of the company's ownership structure by employees' purchases of stocks itself may be advantageous for the management and for some of the owners—sometimes it can be a lifeline against a hostile takeover by other potential investors. And, last but not least, management and owners may support or initiate ESOPs with the intent of linking it to the introduction of a more open system of management, as well as the stronger motivation and more active participation of workers. The unanimous conclusion of several investigations is that ventures of the latter kind do pay: the introduction of employee share ownership entails the improvement of the company's economic performance if (but usually only if) it is coupled with changes encouraging employees' active participation in such schemes (e.g., Quarrey 1987, Rosen et al. 2005, Blasi et al. 1994, Beyster 2008, Kruse 1996).

As for the countries studied, factors described here offered little support to the consolidation and subsistence of the employee ownership established by privatisation. As seen, some tax benefits always accompanied insider privatisation programmes. However, their efficiency was reduced by the economic weakness of many companies (loss-making companies could not exploit tax benefits) and also by the instability of the tax system (which implied that the benefits might be abolished abruptly). Another problematic feature of the system of benefits was that it was concentrated on the starting procedure, i.e., on the manager-employee buyout, with little intent to shape the legal environment "in such a way which would assure that the unfavourable economic environment does not threaten the work of the existing companies based on employee ownership" (Boda and Neumann 2006).

Furthermore, social support, lobbying and the organisations supporting employee share ownership initiatives with professional advice were also missing. In Central Europe, Hungarian and Polish trade unions supported employee ownership, but only in the field of national-level legislation and other regulation. They did not participate in company-level negotiations of individual cases (Boda and Neumann 2006). Slovenian trade unions also supported employee ownership but—unlike many of their Western counterparts—they opposed the compensation of profit sharing (of profit sharing with or without employee ownership) with any reduction in basic wages. And—just like Hungarian and Polish unions—they usually did not play any role in the preparation of concrete deals, in the negotiations with the management and owners. In Poland, trade unions often disappeared after the insider privatisations of companies. And the workers' enthusiasm was also frequently limited. For example, according to public opinion polls carried out in Poland in the 1990s, workers mostly wanted to become owners of the firms employing them, but becoming owners was not what attracted them most. They were more interested in making money, or they thought that this would be the least bad solution (Lowitzsch et al. 2006).

Organisations dedicated to supporting workers' ownership of firms were set up in several countries, but they were not particularly strong. These included the "Rész-vétel" Foundation² in Hungary and DEZAP (Society for Workers' Ownership) in Slovenia. DEZAP was established in 1995 by trade unions, the representatives of some companies, journalists and research workers; it organised conferences and propagated the idea of employee ownership. (There seem to be no traces of its activity after 2004.) Companies owned by employees themselves also established their associations. There were three such associations in Poland, but they did not play any significant role, and their combined membership was less than 300 companies. In Slovenia in some of the companies (but nowhere near all those with significant employee ownership), associations of employees were organised, and they even established a national federation. However, the federation did not play an important role, and the associations were established mainly to purchase the stocks of their "own" companies cheaply. The associations could buy the shares without—the otherwise obligatory—auction. The establishment of such associations was mostly urged by the managers (Lowitzsch et al. 2006).

The various associations of entrepreneurs and managers generally neither supported nor opposed employee ownership. One exception to this

² The Foundation's name means both "participation" and "purchasing a part" (or share).

rule was the Association of Slovenian Managers, which supported it. Managers themselves were motivated to support employee ownership out of fear of the appearance of strong outsider owners (a hostile takeover) that might threaten their power and even their job. This is why they usually supported employee ownership. Furthermore, they often initiated such deals and largely controlled them (Lowitzsch 2006). As for Hungary, a country study on employee ownership quotes the former chairman of the "Rész-vétel" Foundation, according to whom about half of enterprise managers exploited employee ownership from the start only as a cover organisation. Half of the other half of the managers discovered only later that they did not really need their subordinates as owners; they got rid of them. The remaining quarter of managers behaved in a "fair" way (Boda and Neumann 2006, p. 161). (Of course, these estimates are not based on any systematic survey.) According to the study of a staff member of the State Auditing Office, employee ownership was the main device Hungarian managers used to maintain control over their companies. Among the aims of the investigated enterprise managers, the analysis mentions keeping powerful positions, earning profits, intending to invest and preventing takeover by others (but also keeping workplaces, maintaining the culture of the trade and sentimental reasons) (László 2004). Insider privatisations were mostly controlled by the managers in Poland as well, where the investigation of the management culture of such firms found that it was usually more imperious than democratic (e.g., Gardawski 1995).

The distribution of the stocks was usually rather egalitarian at Polish insider privatisations, and their concentration in the hands of managers began only later (Lowitzsch et al. 2006). Elsewhere, such as in Hungary, managers typically obtained bigger portfolios, but their share later increased gradually here too, indicating a trend towards manager domination.

The Hungarian privatisation did not result even temporarily in a significant share of employee ownership (only 1.2 percent of all assets of non-financial corporations was owned by beneficiaries of insider privatisation in 1998). And non-manager employees' roles as owners did not last long. After the repayment of the loan borrowed for the company buyout, the employee shareholders' organisation was usually wound up, and the non-managerial employees sold their shares to the managers (Boda and Neumann 2006). Thus the ownership share of non-managerial personnel decreased gradually in the economy, and its concentration into sectors primarily fitting this kind of ownership was easily discernible in 2000. Namely, significant employee ownership remained mostly in companies

employing few but highly skilled workers, having low capital intensity and producing very specific products in small series (Janky 2002). The rapid shrinking of employee ownership in Hungary also indicates that enterprise self-management traditions, which developed to some extent in this country after the early 1980s with the establishment of enterprise councils, did not help much in cementing employee ownership into the country's economic structure. As will be seen below, employee ownership was not much more durable in Poland either (where enterprise councils were established in the early 1980s, as well as in Hungary, and where later they were even able to play some role in privatisation decisions). On the other hand, this form of ownership became more durable in Slovenia, where self-management traditions were deep-rooted since the early 1950s. However, a causal relationship is not a given: employee ownership was also relatively durable in Russia and Ukraine, without self-management traditions. Thus the issue requires deeper investigation.

More generally, secondary privatisation in the five countries (those other than Hungary) studied here is worth a thorough analysis because it was relatively slow. It was also more complex because it included not only the melting away of employee ownership but also the disappearance of small shareholdership stemming from voucher mass privatisation programmes. And differences among countries were also important.

4.1 Secondary privatisation—the Czech Republic

More than two-thirds of Czech small investors participating in the voucher privatisation became owners of companies through the Privatisation Investment Funds; only the remaining less than one-third were direct shareholders. As already mentioned, PIFs were mostly closed-ended funds or joint-stock companies. These two kinds of PIFs were similar to each other. Namely, the share of the joint-stock company, as well as that of the closed-ended fund, could only be sold to a third party, not to the joint-stock company or to the closed-ended fund itself. This meant that these funds faced relatively little pressure to improve their performance. Indeed, investors in the United States, where there is a wide range of investment options, do not really like closed-ended funds; open-ended funds, whose shares are traded by the funds' operating companies, are far more popular (Weiss and Nikitin 1998). But even though the organisational setup of most PIFs harmed the acceptance and thus the sustainability of the system, abuses related to the PIFs caused much more damage. The gravest and

most notorious abuses did not really emerge before the peak of the second wave of voucher privatisation: managers of Privatisation Investment Funds guarded their good reputation in order to collect as many vouchers as possible in this round as well. But, from 1994–1995 on, methods of robbing the assets of PIFs began to flourish. For example, one PIF contracted to transfer some securities to a “friendly” company, but it did not deliver them, and as a result the PIF had to pay a heavy penalty. In other cases, PIFs bought or exchanged illiquid securities at unrealistic prices, or were damaged by the well-prepared fraudulent bankruptcy of a business partner. In 1996 alone, the police launched 1,420 investigations into similar cases (Myant 2001). (The weak regulation and enforcement that prevailed in those years at the Prague stock exchange is well illustrated by the fact that before 1999 [the year of a radical regulatory reform], no initial public offering [IPO] of the shares of any company was carried out on this market.) Initiatives to protect small shareholders’ rights and interests did occur (there was even an association established with this aim—Ochranné Sdrúžení Malých Akcionáru), but these investors had hardly any other viable option than to sell their investment at a loss (Mejstřík 2003).

It certainly could not be expected that all citizens who participated in the voucher privatisation programme—more than six million people—would remain shareholders in the long term. But the conditions described above should have stimulated their sales of shares considerably. Thus it may seem surprising that only one-third of (direct or PIF-mediated) ownership titles obtained in the first wave of voucher privatisation, and only 15 percent of those obtained in the second wave, had been sold by August 1995 (Myant 2001), and even in 1998 four million small investors’ accounts were active (World Bank 1999c). The surprise may be even bigger if we look at stock exchange turnover, which was not really sluggish in the Czech Republic (see Table 4.1.1), leaving the impression that it was a well-functioning and liquid market.

However, despite the ostensibly fair turnover, the market was not liquid. Privatisation Investment Funds traded—and often bartered—stocks with each other, usually in large amounts and largely outside the stock market. Prices applied at these deals were not disclosed. This kind of trade was aimed at collecting strategic stakes of companies’ stocks. The market in this kind of trade was different from the behaviour of a usual stock market dominated by financial investors (and small investors are always financial investors). Besides that, individual deals were probably often registered more than once (World Bank 1999c).

Table 4.1.1 Annual stock market turnover of the six countries, in percent of stock market capitalisation

Country	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Czech R.	na	46,5	50,5	39,8	36,1	60,0	34,0	37,0	52,0	79,0	118,6
Hungary	na	28,8	47,8	114,6	82,8	95,8	90,7	44,4	46,5	57,6	78,0
Poland	na	62,3	61,2	43,4	36,3	49,9	26,1	28,7	26,6	33,1	36,3
Slovenia	na	58,4	20,7	29,4	31,1	20,7	30,5	27,9	12,7	14,7	9,0
Russia	na	7,3	12,3	15,4	3,6	36,9	39,1	30,1	46,0	53,0	39,0
Ukraine	na	na	na	10,7	8,8	20,0	13,9	14,9	2,9	2,5	3,6

Source: European Bank for Reconstruction and Development

Under such market conditions, citizens holding shares of Privatisation Investment Funds and (to a smaller extent) directly holding the stocks of privatised companies faced a dilemma. The following description of the dilemma is taken from Wintrobe's (1998) investigation of the—rather similar—Russian stock market.

The citizen who considers selling his or her stock finds a potential buyer. The potential buyer—who could improve the company's operation and increase the stock's yield—offers a price exceeding the last (given the market's low liquidity, not very recent) offer. But the citizen considering the sale thinks that the company's operation can probably be improved to such an extent that even the new price offered is too low. Thus he or she would rather wait: let others sell their stocks at that price, and he or she can sell at a better price soon. But those others are thinking the same. In such a situation, without continuous turnover of the stocks and stock prices based on the latter, offer prices and demand prices of stocks may remain far apart. Thus, confounding the expectations of voucher mass privatisation's proponents, good owners did not replace bad ones very quickly.

At the same time, processes of concentration began among the Privatisation Investment Funds. Pohl et al. (1997) investigated 706 companies and found ownership concentration increasing significantly already between 1993 and 1996.³ Some famous (and later infamous) PIF managers emerged as early as the beginning of 1995, who collected company stocks into their quickly increasing funds. (Most famous were the Harvard and Motoinvest groups of PIFs.) These managers committed themselves to enhancing the firms' economic results with investments and highly professional guidance. Later their PIFs vanished amid suspicious circumstances—for instance, via relocations to tax havens, causing their investors serious losses (Myant 2001). Such "ventures" significantly accelerated the depletion of the whole network of Privatisation Investment Funds. Bankruptcies of companies often obviously mismanaged,⁴ and

³ The sample included companies privatised in the first wave of voucher privatisation and others privatised in the second wave. For the former at the beginning of 1993, and for the latter at the time of their privatisation, the average ownership share of the five largest owners was 50 percent. This average increased to 65 percent until the first quarter of 1996 in both groups.

⁴ On the basis of their legal restraints of ownership shares, Privatisation Investment Funds could not be considered much more than financial investors. Consequently, they could not even be expected to manage their companies well. Pavlinek (2002) investigated PIFs' management activities on a sample of companies manufacturing car parts and subassemblies, and of course he found that they were very weak.

sometimes ransacked, contributed significantly to the depletion process. (Bankruptcies were more frequent at companies controlled by PIFs than in the overall average of companies [Lizal 2002]). In 1999, a new, more rigorous regulation and a new agency of supervision, the Czech Securities Commission, was established to oversee the PIFs (substituting for the previous, rather inefficient supervision by the Ministry of Finance). Then all PIFs were obliged to apply for a new licence, and many of them were liquidated (Czech Securities Commission 2004).

Some of the Privatisation Investment Funds were transformed into holding companies. This exempted them from the portfolio diversification rules, allowing them to invest any portion of their capital into one company and own as much of it as they wished. Such a transformation was an obvious incentive for small investors to leave: becoming an investor of a holding entailed reduced transparency and increased risk for them. From 2001 on, closed-ended funds were required to shift to open-ended operation. This change, of course, eased the exit of small investors. Additionally, in the second half of the 1990s, increasing quantities of new, “normal” investment funds began to emerge. After 2001, when the establishment of foreign-controlled investment funds was allowed, they promised safer investment opportunities, often under world-famous brand names. Two hundred and nine foreign-controlled investment funds were established in that year alone, and their number grew to 723 by 2003. The once-numerous and -rich guild of PIFs shrank to a modest size by 2000: 33 funds remained with total assets of 20.4 billion koruny—approximately US \$530 million (and in 2003 the remaining four PIFs’ total assets amounted to about US \$100 million) (World Bank 2004). The restructuring of the banking system contributed significantly to the withering away of the PIF sector. As was already seen, bigger PIFs were mostly under banks’ control, and many loans granted by banks to companies controlled by their PIFs were substandard or simply bad. As banks’ portfolios were cleaned, PIFs had to be separated from their mother banks and companies from the controlling PIFs (World Bank 1999a).

The dispersed ownership structure of the companies that had been established by voucher privatisation changed earlier than that. Kočenda and Valachy (2001) investigate the change in the ownership structure of 645 companies that had been included in voucher privatisation. In them, the mean stake of the largest owner grew from 39 to 52 percent, and that of the five largest owners from 57 to 69 percent. Their investigation also included a kind of cluster analysis of the development of the single largest owner. If the latter’s stake in a given year was below 35 percent, it was

classed into the first cluster; between 35 and 63 percent, it went into the second; and if the largest owner owned more than 63 percent, then the company belonged to the third cluster. Table 4.1.2 shows that the fundamental trend of transitions between clusters was the increase of the share of the single largest owner. Sixty percent of companies with the largest owners with a share not exceeding 35 percent left this cluster between 1996 and 1999. In the same period, only 21 percent of the companies whose largest owner had a share exceeding 63 percent left this cluster, going into a lower level of ownership concentration.

Table 4.1.2 The movement of Czech companies between clusters according to the ownership share of the largest owner, 1996–1999

		Cluster in 1999			
	Clusters according to largest owner's ownership share	1(<35%)	2(35–63%)	3(>63%)	
Cluster in 1996	1(<35%)	40%	39%	21%	100%
	2(35–63%)	10%	53%	37%	100%
	3(>63%)	2%	19%	79%	100%

Source: Kočenda–Valachy [2001]

Table 4.1.3 The average ownership share of the largest owners in the Czech Republic according to the type of owner

Type of the single largest owner	Year	Number of observations	Average ownership share
Non-financial company	1996	337	44,82
	1999	442	54,27
Bank	1996	25	36,41
	1999	18	41,2
Privatisation Investment Fund	1996	171	28,82
	1999	116	43,16
Physical person	1996	104	34,45
	1999	132	43,29
Portfolio society	1996	56	35,9
	1999	22	50,93
State	1996	55	35,62
	1999	18	46,16

Source: Kočenda–Valachy [2001]

Table 4.1.3 also displays data on company owners possessing the highest shares. It shows that (within the above-mentioned group of 645 voucher-

privatised companies) the number of those companies whose largest owner was a PIF or the state diminished significantly between 1996 and 1999, and the number of those with a non-financial company or a private person as their largest owner grew. This table also shows that the stake of the largest owner increased for all kinds of owners. (That includes the state, which was trying to get rid of the relatively small ownership stakes that it had “managed” rather passively since the beginning of privatisation.⁵ Besides portfolio companies,⁶ PIFs increased their ownership stakes in those companies in which they were the largest owners. This trend reflected the changing role of some PIFs: as they became holding companies, they sought to become majority owners.

The data used above do not treat foreign owners separately. According to another source (Sabirianova et al. 2005), foreign investors’ average share in the subscribed capital of industrial companies was 3.5 percent in 1992, 12.7 in 1996 and 30.7 percent in 2000. The increase of this proportion was partly the result of continued (now not mass) privatisation but obviously not only of that, since the share of acquisitions from privatisation by total foreign direct investments was diminishing in the second half of the 1990s (from 95 percent in 1995 to 61 in 2000). Besides such (still important) direct privatisations to foreigners, and besides greenfield and so-called “brownfield” investments (investments in previously acquired factories and the like), purchases by foreigners of shares in mass privatised companies were obviously also growing. At the end of 2001, about 3,400 companies were already owned partly or wholly by foreigners. Foreigners owned 100 percent of the shares at 64 percent of these companies, more than 50 percent at 25 percent of the companies, and less than 50 percent at 11 percent of them (Mejstřík 2003). With the foreign investment boom that started in the second half of the 1990s, the cumulative sum of foreign direct investments in the Czech Republic between 1989 and 2002 reached US \$36.7 billion, a higher result than in the former leader, Hungary (US \$33.2 billion) (see Table 4.1.4).

⁵ A 1995 survey found that 82 percent of company general directors and 64 percent of members of company boards of directors thought that board members delegated by the National Property Fund were passive. On a scale grading activity level between 1 (passive) and 3 (active), they put them at 1 (Schwartz 1997).

⁶ Portfolio companies did not seek to participate in the management of the companies whose shares they owned. Their activity was restricted to trade with company stocks. Of course, many Privatisation Investment Funds were actually also satisfied with this much, but in principle they were active participants in control and management, even though their ownership share restriction made this rather problematic.

Table 4.1.4 Foreign direct investments in the six countries from 1989 to 2002, in million US dollars

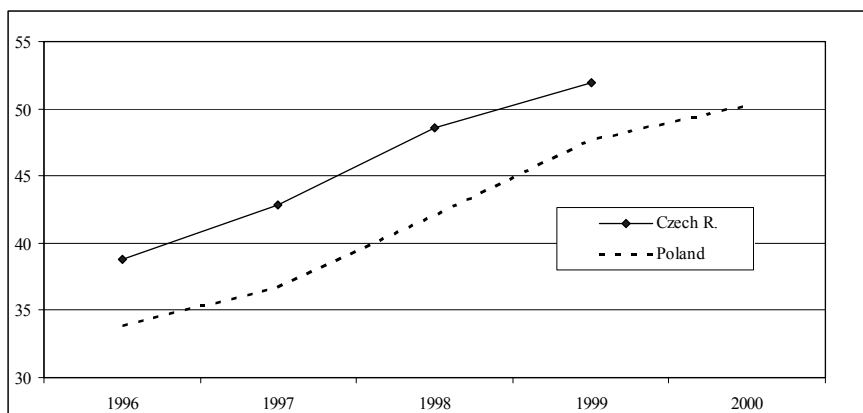
Country	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	1989–2002
Czech R.	171	120	511	983	564	762	2531	1280	1259	3575	6220	4942	5474	8282	36673
Hungary	187	311	1459	1471	2328	1097	4723	3292	3703	3082	3059	2151	3576	2721	33160
Poland	n.a.	0	117	284	580	1846	3617	4445	4863	6049	7239	9327	5804	3901	48072
Slovenia	n.a.	n.a.	-41	113	111	129	161	167	303	221	59	71	226	1508	3027
Russia	n.a.	n.a.	n.a.	n.a.	n.a.	408	1460	1656	1681	1492	1102	-463	216	-72	7480
Ukraine	n.a.	n.a.	n.a.	n.a.	n.a.	151	257	516	581	747	489	594	769	698	4802

Sources: European Bank for Reconstruction and Development and Estrin [1996]

4.2 Secondary privatisation—Poland

As seen in subsection 3.5, voucher mass privatisation and privatisation by liquidation were the two main paths taken by Polish privatisers. Voucher mass privatisation applied in Poland was rather different from the Czech version. Vouchers could only be exchanged for the shares of the 15 National Investment Funds (one share of each NIF). Exchanging the vouchers directly for the shares of the privatised companies was not possible. Beyond that, the 15 NIFs were originally established by the government, rather than the private sector, and (only) those 15 operated until the end of this privatisation programme in 2005. The NIFs' activities were rigorously supervised.

Graph 4.2.1 The development of the average ownership share (measured in percent) of the largest owners of Czech and Polish companies privatised with the voucher method



Source: Grossfeld–Hashi [2004]

However, the concentration process of the ownership of mass privatised companies in Poland was basically similar to what was observed in the previous subsection in the Czech Republic. Graph 4.2.1 reflects this similarity: the mean stake of the largest owner of mass privatised companies exceeded 50 percent in 2000. (This happened a year earlier in the Czech Republic, but there the mass privatisation also started earlier.) In interpreting the Polish data, it must also be remembered that initially, in 1996, the largest owner of each company was a National Investment Fund. In 2000—when most of the many Czech Privatisation Investment Funds no

longer existed—National Investment Funds as owners of mass privatised companies no longer dominated in Poland either.

Table 4.2.1 The largest shareholder in Polish mass-privatised firms

	1998	1999	2000
Foreign investor, no. of firms	33	44	52
Average ownership share, percent	61,27	64,87	75,11
Domestic investor, no. of firms	406	395	387
Average ownership share, %	49,46	48,73	47,02
Of which:			
employees, no. of firms	9	13	13
Average ownership share, percent	43,29	65,81	55,3
individual, no. of firms	15	29	39
Average ownership share, percent	63,01	54,2	57,52
company, no. of firms	75	100	124
Average ownership share, percent	58,09	56,07	61,25
NIF, no. of firms	298	243	199
Average ownership share, percent	46,56	44,65	37,25
State, no. of firms	9	10	12
Average ownership share, percent	57	36,29	18,7
Total, no. of firms	439	439	439

Source: Grossfeld–Hashi [2004]

Table 4.2.2 The largest shareholder in Czech mass-privatised firms

	1996	1997	1998	1999
Individual, no. of firms	89	92	104	108
Average ownership share, percent	35,12	36,4	39,39	44,77
Company, no. of firms	295	371	372	404
Average ownership share, percent	46,6	47,95	53,9	55,62
PIF, no. of firms	148	127	116	96
Average ownership share, percent	27,97	32,73	42,03	46,27
Financial institution, no. of firms	58	33	41	27
Average ownership share, percent	38,03	42,44	47,7	51,27
State, no. of firms	62	29	19	17
Average ownership share, percent	33,05	40,64	37,07	42,99
Total, no. of firms	652	652	652	652
Average ownership share, percent	38,75	42,75	48,59	51,94

Source: Grossfeld–Hashi [2004]

The development of the ownership structures of Polish and Czech mass privatised companies is displayed in Tables 4.2.1 and 4.2.2, respectively. The tables reveal that the most important new owners of previously mass

privatised companies were (other) non-financial companies. (Unfortunately, again, no separate data is available on the role of foreign entities in the Czech Republic.) Non-financial companies bought high stakes in more companies than owners of other types did, and they also sought to acquire the highest ownership shares. The “main owner” role of the funds—particularly that of the Privatisation Investment Funds in the Czech Republic—receded substantially (especially since these data already also include other funds of a new kind). At the same time, at 199 of the 439 companies observed in Poland, a National Investment Fund was still the largest owner (although the mean stake assuring the largest owner status was lower at NIFs than at any other type of owner).

However, the ownership structure of the NIFs themselves also became increasingly concentrated. As seen in subsection 3.5, the proportion of Treasury ownership in these funds was initially 100 percent, and it diminished only gradually (reaching 13.4 percent at the end of 2000). Among owners other than the Treasury, the average highest stake was 5.4 percent in mid-1998, 19.3 at the end of 1999 and 23.9 percent at the end of 2000, and the average share of the three largest owners was 7.0, 36.4 and 41.8 percent, respectively. The “entitled” small owners (those who became owners by exchanging their vouchers for shares) theoretically might have owned 85 percent of the shares (all except the 15 percent originally kept and later sold by the Treasury), but their proportion probably never rose close to that level. This can be explained by the speed with which some of the “entitled” owners exchanged their vouchers for shares in NIFs and then sold those shares, as well as the slowness of others in exchanging their vouchers for shares. According to the first available data, the proportion of all small owners (the “entitled” ones and any others who had ownership stakes of less than five percent) was 50 percent at mid-1998 and fell to 41 percent by early 2001. The average stake of domestic large owners was 4.1 percent in mid-1998 and 13.5 percent in January 2001, while the foreign owners’ average share was 2.5 and 26 percent, respectively. Controlling stakes of NIFs were traded at the Warsaw stock market, often by foreign (e.g., Deutsche Bank) or domestic (e.g., Pekao S. A.) financial institutions of good standing. The NIFs’ activities were already rather far from the role that they had played in privatisation, and if their management costs had not used up a significant portion of their capital, they might even be considered efficient components in the establishment of the capital market (Grossfeld and Hashi 2004, Błaszczak et al. 2001, Woodward and Kozarzewski 2004).

The other main Polish privatisation pattern was privatisation by liquidation, which—along with mass privatisation—resulted directly in dispersed ownership. As seen in subsection 3.5, after such deals it was almost exclusively new firms, established by the liquidated companies' non-managerial employees and managers, that leased the assets (the average share of outsider owners was eight percent). By the end of 1994, 1,478 companies (more medium-sized than large ones), three-quarters of all those privatised, became insider-owned in this way, with 450,000 employees (in Hungary, these figures were 178 and 36,000, respectively; in the Czech Republic three companies were insider-owned) (Estrin 1996). According to Mickiewicz and Baltowski (2003), the Polish manager-employee buyouts were followed, within two to three years, by one of two kinds of developments: (1) the emergence of a group of dominant owners, whose members usually belonged to the highest echelons of management, or (2) the seizure of control over the company by another company, which incorporated it into a holding structure. The first was a model of well-operating companies, while the second was a model of poorly operating ones. Kozarzewski and Woodward (2001) investigated the development of the ownership structure of Polish insider privatised companies, good and bad, on the basis of a sample of 110 entities. Their results, displayed in Table 4.2.3, support the Mickiewicz–Baltowski thesis of the two models.

Table 4.2.3 The evolution of the ownership structure of insider privatised companies in Poland, by net loss vs. net profit (weighted averages; data in percent)

	Strategic investor	Other (financial) outsider	Managers	Non-managerial employees
Property %				
Net loss in 1993				
Initial	-	-	49,9	50,1
1997	7,4	8,1	55,9	28,6
1998	9	24,6	50,8	15,6
1999	50	17	17,9	15,1
Net profit in 1993				
Initial	0,2	5,8	31	63
1997	5,8	13,2	35,2	45,9
1998	13,9	16,8	34,1	35,2
1999	11,8	22,9	31,7	33,6

Source: Kozarzewski–Woodward [2001]

Changes in the ownership structure were restricted by the statutes of the companies. The main thrust of the rules was usually to resist the increasing influence of outsider investors, including the sale of insiders' shares to them. Kozarzewski and Woodward (2001) have found clauses restricting the sale of shares in the statutes of 87 percent of their sample of insider privatised companies. The restrictions usually served three purposes: keeping would-be outsider owners away, increasing the ownership share of the management, and hindering the emergence of any significant owners' group within the company but outside of the management. The rules (e.g., forbidding or regulating the sales of shares) slowed changes of ownership structures that went against the managers' interests, but they could not really prevent them. Aside from sales of existing shares, new issuances also contributed to ownership changes—of course, very rarely in favour of outsiders.

Changes in ownership structures were also influenced by the sizes of companies. Outsiders' proportions increased faster at larger companies—obviously because outsiders usually had significant financial resources. At small companies (with no more than 100 employees), the average stake of strategic and financial outsider investors started from 8.3 percent at the time of (insider) privatisation (in different years between 1991 and 1997), and it increased only to 15.5 percent by 1999. The same two owner groups, starting from a similar level, reached an average share of 23.7 percent at medium-sized companies (101 to 200 employees). However, at medium-sized companies, outsiders were predominantly financial investors, so much so (see Table 4.2.4) that the 40.6 percent average share of the management was not increased to 50 percent by the average proportion of strategic investors (who—it can be supposed—usually were allies of the management). But of course, less than 50 percent most often must have been sufficient for the majority of votes, since financial investors tended to be passive. The mean weight of all outsiders was 7.3 percent at large companies (with more than 200 employees) initially; in 1999 strategic owners reached 17.6 percent, and financial owners 24.7 percent. Of course, such a high share of financial investors made things comfortable for managers (possessing 27.3 percent on average) and outsider strategic owners. The mean stake of non-managerial employees at this group of large companies almost exactly halved by 1999: originally, at the time of privatisation, it had been 60.1 percent, and it shrank to 30.2 percent.

The corollary is that the insider ownership pattern established by the Polish privatisation by liquidation, involving significant non-managerial participation, was narrowed down to small firms (similarly to the Hungarian

case). At the same time, medium-sized companies, let alone large ones, that had been privatised like these small ones increasingly got rid of non-managerial employee ownership—by 1999 their managers and strategic outsider investors were more likely than not to be in dominant positions.

Table 4.2.4 Poland: changes in ownership structures, by sizes of the companies (data in percent)

	Strategic investor	Other (financial) outsiders	Managers	Non-managerial employees
Small				
Initial	2,7	5,6	36,6	55,2
1997	2,1	5,7	40,8	51,4
1998	2,6	9,3	45,1	43
1999	4,7	10,8	40,1	44,4
Medium-sized				
Initial	1,8	6,4	38,4	53,4
1997	2	13,9	45,1	39
1998	2,4	10	46,8	40,8
1999	4,4	19,3	40,6	35,7
Large				
Initial	1,2	6,1	32,6	60,1
1997	7,7	13,4	36,6	42,1
1998	15,7	20	33	31,3
1999	17,6	24,7	27,3	30,2

Source: Kozarzewski–Woodward [2001]

The development of the ownership structure of privatised Polish companies between 1998 and 2000 is displayed, in a breakdown by the time of privatisation, in Table 4.2.5. Long-term trends are best reflected by changes in the ownership structure of companies privatised earlier: the shrinking shares of National Investment Funds and banks are visible (although the proportion of the latter had *ab ovo* been rather modest), as is the increasing weight of company managers and particularly foreign investors. The rather rapid secondary privatisation also deserves attention, and gets further analysis below, because it was rapid despite the lingering reform of public administration. In Poland, sectoral ministries retained control over state-owned company shares for a long time. Only in 1996 was this control transferred to the Treasury (Nunberg and L. Barbone 1999), facilitating primary privatisation and also—at companies in which the state retained some ownership—secondary privatisation.

Table 4.2.5 Ownership structure of 100 Polish companies by the year of privatisation (the last sale of their shares; data in percent, unweighted averages)

Shareholder type	Sold in 1989-93			Sold in 1994-97			Sold after 1997		
	1st January	1st January	1st January	1st January	1st January	1st January	1st January	1st January	1st January
	1998	1999	2000	1998	1999	2000	1998	1999	2000
Managers	3,3	2,4	6,3	4,8	3,5	3,5	1,2	1,1	3,8
Non-managerial employees	11	10,4	9,8	8,5	8,6	7,1	10,1	7,2	5,9
Former employees	1,7	4,3	1,5	5,3	5,5	4,9	3,6	3,2	2,8
Individuals	18,8	16,8	16	7,2	7,2	10,8	18,7	19,1	13,4
State	4,1	3,6	3,6	11,3	10,7	10,7	13,7	13,6	12,4
Domestic non-financial company	10,1	9,5	10	12,4	13,7	10,7	9,8	10,7	13,4
National Investment Fund	8,9	8,9	5,4	13,8	13,4	8,7	17,4	15,6	10,1
Bank	4,3	2,6	2,1	2,4	3	2,3	2	1,5	4,5
Foreign investor	22,4	25,3	31,7	19,5	19,8	25,9	10,1	15,9	19,4
Other	15,4	16,2	13,6	14,8	14,6	15,4	13,4	12,1	14,3

Remark: This Table has two flaws. First, it is based on the data of only 100 companies (mainly from processing industries), including 84 of the 500 largest companies and 16 other, also relatively large ones. The number of their employees is between 85 and 4518. The other flaw is that in the original, the data sum up to 90 to 95, rather than 100, by columns. Here, we have increased the last row (other) by the unexplained differences.

Source: Kozarzewski [2002]

4.3 Secondary privatisation—Slovenia

Primary privatisation was followed by a much slower secondary privatisation in Slovenia than in the Czech Republic or Poland. Table 4.3.1 displays the average ownership shares of various types of owners by the three groups of privatised companies already described (see subsection 3.6): publicly privatised companies, insider privatised companies and companies privatised to outsiders.

Table 4.3.1 Ownership structures of Slovenian companies at the time of the completion of privatisation

Owner types	All companies	Publicly privatised (introduced to stock exch.)	Insider privatised	Privatised to outsiders
State	7,75	6,78	2,02	11,92
Compensation and Pension Funds	21,60	20,49	21,28	22,19
Privatisation Investment Funds	19,38	17,65	14,88	22,99
Funds total	40,98	38,14	36,17	45,18
Insiders—company managers	3,86	1,40	4,98	3,95
Insiders—non- manag. empl's	29,23	21,88	38,08	25,80
Insiders—former employees	11,05	7,48	14,60	9,89
Insiders total	44,14	30,77	57,66	39,65
Domestic financial investors	4,80	22,37	0,63	1,61
Foreign financial investors	0,03	0,08	0,00	0,02
Financial investors total	4,83	22,45	0,63	1,64
Domestic strategic investors	2,00	1,86	3,55	1,01
Foreign strategic investors	0,30	0,00	0,00	0,60
Strategic investors total	2,30	1,86	3,55	1,61
Grand total	100,00	100,00	100,00	100,00

Source: Simoneti et al. [2001]

Table 4.3.2 Changes in the ownership structures of Slovenian companies from the completion of privatisation to the end of 1999 (data in percent)

Owner types	All companies	Publicly privatised (introduced to stock exch.)	Insider privatised	Privatised to outsiders
State	-4,69	-3,98	-1,47	-7,09
Compensation and Pension Funds	-9,02	-6,49	-9,16	-9,78
Privatisation Investment Funds	-2,13	1,37	-0,31	-4,54
Funds total	-11,15	-5,13	-9,47	-14,32
Insiders—company managers	5,17	1,45	4,09	7,16
Insiders—non- manag. empl's	-2,19	-6,54	-4,52	0,85
Insiders—former employees	0,35	-1,69	-1,39	2,21
Insiders total	3,33	-6,78	-1,82	10,22
Domestic financial investors	3,73	1,71	3,92	4,29
Foreign financial investors	0,15	0,06	0,30	0,09
Financial investors total	3,88	1,77	4,22	4,38
Domestic strategic investors	7,90	13,68	8,01	5,85
Foreign strategic investors	0,72	0,44	0,52	0,96
Strategic investors total	8,62	14,12	8,53	6,81

Source: Simoneti et al. [2001]

Table 4.3.2 shows the change of this ownership structure from the date of privatisation to 2000 at 183 companies. To the extent that the table distorts changes, it increases rather than decreases them⁷ but even so, they are very limited. Essentially the shares of the state and the two state funds were shrinking (i.e., privatisation continued, but shares already privatised were rarely resold, at least rarely to owners of different types). And even the growth of the share of strategic investors (i.e., those with more than 10 percent shares) brought changes that were, in part, only formal, because

⁷ At companies privatised to outsiders, some increase of the ownership share of outsiders can be observed; this is, at least partly, the consequence of changing methods of measurement.

these strategic investors were often companies established by insiders (managers). Furthermore, those companies whose parts had been detached before privatisation but who later acquired them again, partly or wholly, appeared as “new strategic owners”.

The dispersion of the ownership lessened somewhat, but it remained very strong in the years following privatisation (Simoneti and Gregorič 2004, Simoneti et al. 2001, Gregorič and Vespo 2003). In mid-2000, 67 percent of 136 companies quoted at the stock exchange and 37 percent of a sample of 578 companies had no owner possessing at least 25 percent of the shares. Table 4.3.3 shows clearly the lack of dominant owners at these two groups of companies.

Table 4.3.3 Average stake (in percent) of different groups of the largest shareholders in quoted and not quoted Slovenian companies (based on July 2000 data)

Owner types	Number of quoted companies	Average stake in percent	Number of not quoted companies	Average stake in percent
Domestic individuals	11	21,3	46	27,1
Foreign owners	7	38,3	17	49,2
Banks	4	32,6	4	71,9
Pension Fund	21	17,4	44	22,2
Compensation Fund	8	15,7	10	15,7
Privatisation				
Investment Fund	51	25,0	173	30,2
Non-financial company	28	40,4	175	50,6
Organisation of employees	1	39,1	31	45,6
State	4	24,3	36	47,2
Slovenian Development corporation	1	64,3	29	43,2
Insurance company	0	0,0	4	41,2
Other legal entities*	0	0,0	9	30,7

* Clubs, etc.

Source: Gregorič et al. [2002]

Table 4.3.4 displays the average ownership structure of 183 companies: the actual stakes of different owner types and those desirable according to the managers of the companies.

Clearly, managers would have been happy to rid themselves of all funds—state and privatisation funds alike. They were more or less satis-

fied with the stakes of domestic and foreign financial investors (the stake of foreign financial investors was next to nothing). They expected more strategic owners, some from abroad, but more from within the country. Furthermore, they would have increased not only their own stakes but also those of non-managerial employees, and (on average) they preferred the absolute majority of insiders (Simoneti and Gregorič 2004). These managerial wishes are not surprising, and they are important because the large actual weight of insider owners allowed managers significant influence over further changes in the ownership structure. However, their power was certainly not unlimited. Often their initiatives to take in new owners were thwarted by other owners (Ribnikar 2000). Basically, in the dispersed ownership structure, trends towards significant change were weak.

Table 4.3.4 Ownership structure at 183 Slovenian companies in 1999: actual and optimal structure according to the companies' managers (in percent)

Owner types	Actual stakes	Optimal stakes
State	3,06	1,55
Compensation and Pension Funds	12,58	4,86
Privatisation Investment Funds	17,25	6,44
Funds total	29,84	11,31
Insiders—company managers	9,03	21,8
Insiders—non-manag. empl's	27,04	29,48
Insiders—former employees	11,4	4,8
Insiders total	47,47	56,08
Domestic financial investors	8,53	7,31
Foreign financial investors	0,18	0,61
Financial investors total	8,71	7,93
Domestic strategic investors	9,9	16,92
Foreign strategic investors	1,02	6,21
Strategic investors total	10,92	23,14

Source: Simoneti–Gregorič [2004]

Still, concentration did progress slowly. According to a 2002 survey of 150 large and medium-sized companies, the average stake of the largest owner was only 31.8 percent in 1998; it increased to 38.5 percent in 2001, and the average stake of the second largest owner rose from 13.0 to 14.7 percent between these two years. Foreign (strategic and financial) owners' stakes also expanded slowly (from 3.0 to 6.7 percent) (Damijan et al. 2004).

The turnover of company shares was hindered by the temporary and partial banning of the sale of insiders' stakes (see subsection 3.6). In practice, these shares could be sold, but only in forward patterns, and with the

simultaneous alienation of voting rights, sometimes for years (Simoneti et al. 2001). Human ingenuity found a solution, but only an overly complicated one, which did not give buyers and sellers much help in finding each other. Prices had to reflect the circumstances and risks of such deals, meaning that different shares of the same company might have different prices. Further price differentiation was caused by wholesale sales and purchases of shares by Privatisation Investment Funds, often over the counter. To make deals of the latter kind more orderly and transparent, a separate “wholesale” division was established at the Ljubljana Stock Exchange (Gregorič et al. 2001). The turnover of company shares was also hindered by the difficulties of Privatisation Investment Funds caused by the so-called “privatisation gap”. Namely, after mass privatisation vouchers were distributed in 1994 and PIFs collected many of them, the sale of companies providing opportunities to exchange vouchers for company shares progressed more slowly than planned; the full “servicing” of voucher holders with supply of shares lasted eight years. As late as 1998, 56 percent of the PIFs’ vouchers were waiting for supply. The PIFs’ policies were directed at keeping and increasing their stakes in their larger firms and getting rid of smaller ones (World Bank 1999b). These institutions, neither really strategic nor financial, became long-term investors in larger companies, reflecting the lack of both strategic and financial investors. In 2002 an amendment of the law regulating PIFs abolished the rule by which they could not invest more than 10 percent of their capital into one company. Thus many of them more easily became majority owners of one or a few companies, substituting to some extent for the lack of strategic owners (Prašnikar et al. 2002).

4.4 Secondary privatisation—Russia

In their (1995) book on Russian privatisation, Boycko, Shleifer and Vishny wrote that the highly dispersed ownership structure in which (primary) privatisation resulted would fast become concentrated. Most other authors agreed: the high risks and high costs of controlling the managers would compel small owners—citizens owning company shares or shares of Privatisation Investment Funds and non-managerial employees owning shares of companies employing them—to sell their stakes quickly (e.g., Filatotchev et al. 1995).

However, secondary privatisation was not that rapid in Russia either (early on, Frydman, Pistor, Rapaczynski and Turkewitz [1996] perceived

the unexpectedly slow pace). And in Russia—as well as in Slovenia but to some extent also in Poland—insiders tended to remain owners for a much longer term than outside small owners did. The other two groups—small shareholders of companies and PIFs—played a limited role in the literature of Russian privatisation. In the first years after voucher privatisation, they were disappointed by the fluctuating prices and limited saleability of their shares (because until the mid-1990s only 30 to 40 companies' shares had liquid markets). They sensed (often with reason) intrigues behind these phenomena, and, eventually giving up hope, they sold their shares for whatever they could get for them.

As for PIFs, of the 636 established by the end of 1993, 351 remained after three years. Among those that remained, the most successful were those that became parts of some of the financial-industrial groups.⁸ Less than half of the reduction was the consequence of mergers and transformations (mostly into corporations); the other PIFs were liquidated. The unpopularity of the PIFs was exacerbated by their closed-ended form, similarly to what was seen with Czech Privatisation Investment Funds (subsections 3.2 and 4.1). PIFs were also weakened by the low level of liquidity of the stock market. And of course, insiders' groups, which largely dominated company decision-making, restricted PIFs' role in corporate governance and their opportunities to earn dividends as well. Furthermore, unlike other legal entities, PIFs were subject to double taxation. (This was obviously a mistake in legislation. It should have been corrected but—probably because of PIFs' unpopularity—never was.) In 1995—after the accomplishment of voucher privatisation—Parliament approved a law on investment funds of a new kind. They were open-ended and not double-taxed. Although they also suffered from the previously mentioned problems of corporate governance of the firms whose shares they owned, they were more popular with investors and stronger than traditional PIFs, of which only 20 to 30 were considered to have good economic prospects (Pistor and Spicer 1997).

Table 4.4.1 demonstrates changes in the ownership structure, based on a sample of 277 medium-sized and large enterprises. The table shows the reduction of insiders' proportion from 49.8 percent by approximately 10 percentage points between 1995 and 2000; mainly individuals' stakes

⁸ The economic empires of Russian business magnates called oligarchs (many of whom also played important political roles during the 1990s) are called financial-industrial groups or FIGs. A good analysis of FIGs can be found in Hoffman (2003), particularly in Chapter 12.

expanded, from 13.5 to 19 percent, at their expense. Other sources report higher insider stakes: Kapelyushnikov (2000) indicates 46.2 percent in 1999, and Kuznetsov et al. (2001) cites about 62.3 percent in 2000. (Unfortunately, these authors do not analyse the breakdown of outsiders' ownership shares.)

Table 4.4.1 The development of the ownership structure of a sample of 277 Russian large and medium-sized companies

Owner type	Stake size (percent)		
	1995	1998	2000
Non-managerial employees	42	31,1	29,8
Managers	7,8	9	9,5
State	9,7	8,4	8,9
Foreigners	1,8	3,7	3,3
Russian banks	1,6	1,3	1,2
Russian investment companies and funds	9	11,8	11,2
Non-financial companies	12	13,9	14,9
Individuals	13,5	18,6	19
Other	2,6	2,2	2,2

Source: Dolgopiatova [2002]

According to Angelucci et al. (2002), insiders' positions were most solid at companies with good medium performance. The authors investigated changes in the ownership structure of three groups of medium-sized and large companies (employing an average of 900 persons) between their privatisation and 2001. The initial average insider ownership stake was above 70 percent in each group. This proportion shrank by only five percentage points at the 91 companies that had good medium performance in terms of profitability and stability; at the 245 weak firms, the average decrease reached 10 percentage points, and at the 66 very good ones the decrease reached 15 percentage points. The rapid enhancement of outsider ownership at weak companies is hardly surprising (it was also the case in Poland: see subsection 4.2 and, within it, Table 4.2.3). But, as the authors also mention, physical persons and legal entities connected to management often appeared in the form of outsider owners. Other sources see evidence of the latter trend in the frequent under-representation of outsider owners in companies' boards of directors and supervisory boards (e.g., Dolgopiatova 2002). In any case, despite these differences, the decrease of the size of insider ownership was slow, and it remained so. The Russian Economic Barometer's surveys, repeated every other year at about 150

companies, showed that insiders' total stake dropped from 54 to 50 percent between 1995 and 1999, but it was still 48 percent even in 2005. At the same time, the proportion between managers and non-managerial employees gradually changed within insiders: the former grew from 11 to 31 percent, while the latter shrank from 43 to 16 percent of the total between 1995 and 2005, and sister companies appeared among the insiders, albeit (formally) with only 1 percent weight (Aukutsionek et al. 2005).

Table 4.4.2 Ownership structure of Russian firms with different dominant owners in 1997, in percent

Owners	Dominant owner			
	Managers	Non-managerial employees	Non-financial outsiders	Financial outsiders
Managers	53	14,6	7,8	8,9
Non-managerial employees	24,5	58,5	21,3	17,9
Insiders total	77,5	73,1	29,1	26,8
Firms	1,5	4,7	42,1	4,4
Private individuals	10,1	13,7	19,8	7,7
Non-financial outsiders total	11,6	18,4	61,9	12,1
Commercial banks	0,7	0,7	0,8	2,9
Foreigners	1,8	a	0	14
Privatisation				
Investment Funds	a	2,8	3,9	16,7
Holdings and investment funds	0	1,1	0,8	23,5
Financial outsiders total	2,5	4,6	5,5	57,1
Other outsiders	6,6	0,9	0,7	1
State	1,8	3	2,8	3
Total	100	100	100	100

Remark: based on an—according to the authors, “fairly representative”—sample of 125 companies. The number of companies dominated by managers was 14, those dominated by non-managerial employees 57, by non-financial outsiders 38, by financial outsiders 16.

At the same time, as is shown in Table 4.4.2, behind the ownership structure, which on average seemed dispersed, companies dominated by different kinds of owners emerged. The table is based on the data of a sample of 125 companies that well represented Russian medium-sized and large companies. Eleven percent of the companies were dominated by managers

and 46 percent by non-managerial employees. In the other companies, insiders were a minority, and outsiders dominated: non-financial outsiders at 30 percent, financial outsiders at 13 percent. The average proportion of insiders was close to 30 percent even at companies dominated by outsiders (Aukutsionek et al. 1998). These findings—according to which insiders dominated somewhat more than half of the companies should be modified, in line with what was said above, on the basis of—two (quantitatively not known) factors. On the one hand, insider domination was typical mostly of smaller companies. This is supported by various available data. For example, Guriev et al. (2002) found, on the basis of surveying 2002 data of a sample of 1,000 companies, that at companies employing 51 to 200 persons, the average stake of managers was 33 percent, and that of the largest outsider owner was only 15 percent. The corresponding figures at companies with 1,000 to 2,000 employees were 20 and 27 percent, and at companies with 10,000 to 20,000 employees 7 and 29 percent, respectively. This suggests that weighted averages of insider ownership stakes would be lower than the calculated unweighted ones. But, on the other hand, behind outsider owners often stood company managers.

Table 4.4.3 shows the process of slow but tangible concentration of ownership. Among the largest owners, the average of their stake was larger than its median. This means that they held small stakes in a relatively large number of companies, and large stakes in a few companies.

Table 4.4.3 Indicators of the stakes of the largest owner and the three largest owners on the basis of a sample of 277 Russian medium-sized and large companies

Owner groups	Indicators of ownership share in percent					
	1995		1998		2000	
	Average	Median	Average	Median	Average	Median
Largest owner	26,3	22	27,8	23	28,8	24,2
Three largest owners	40,5	40	45,1	44,5	46,5	46,3

Source: Dolgopiatova [2002]

4.5 Secondary privatisation—Ukraine

The mostly insider Ukrainian privatisation (initially based on leasing deals and later continued with vouchers and preferential loans) was followed only by slow changes in the ownership structure.

Table 4.5.1 demonstrates the slow pace of secondary privatisation. The stakes of non-managerial employees shrank, but partly in favour of former employees; that is, even those leaving their companies (partly) kept their shares. Company managers were another group that increased its stakes. (Their positions were also strengthened by the State Privatisation Fund, which—particularly before 2000—ceded to the managers the voting rights connected to the shares remaining in state property [see subsection 3.4]). Ukrainian companies obtained stakes almost entirely in the companies already initially controlled by outsiders, and the—otherwise rather tiny—increase in foreign stakes also concentrated on these companies. Another investigation, carried out on a sample of 202 medium-sized and large companies in 2000, found a somewhat lower share (47.9 percent) of insider owners, and assessed its drop at 3.5 percentage points over two years (but within this, the stake of managers increased by 1.5 percentage points). At the same time, the type of the largest owner changed at 12 percent of the companies; in two-thirds of these cases, insiders lost out to outsiders (Akimova and Schwödiauer 2003). Yet another analysis found significant changes in the stakes of owner types—but changes in favour of insiders. Namely, in a sample of 270 (by no means small) companies, the average stake of insider owners increased from 44 percent in 1999 to 57 in 2000 and to 64 percent in 2003 (Kostyuk and Koverga 2007).

Despite the slow pace of the changes in average proportions of the different types of owners, some process of concentration took place. Considering the managers of the same company as one owner, the average stake of the largest owner in the above-mentioned sample of 270 companies increased from 38 to 44 percent between 1998 and 2000. The number of companies whose largest owner was the group of their managers diminished (from 44.4 to 38.8 percent), and the number of companies with foreigners as the largest shareholders increased relatively quickly (from 10.3 to 15.5 percent). This means that controlling stakes of companies did have a turnover. The fact that at the same time non-managerial employees sold little of their shares can be explained partly by intra-enterprise controls forbidding or restricting sales but also by the poor operation of the stock market: huge price fluctuations and weak transparency (Elborgh-Wotek and Lewis 2002). Further explanatory factors will be addressed in Sections 5 and 6.

Table 4.5.1 The change of the ownership structure of Ukrainian companies between their first shareholders' meeting after privatisation and 1999 (in percent, on the basis of a sample of 230 companies)

Owner type	In 1999			At the time of the first shareholders' meeting		
	All companies	Companies controlled by insiders	Companies controlled by outsiders	All companies	Companies controlled by insiders	Companies controlled by outsiders
State	7,6	2,7	7,1	10,1	5,3	11,7
Insiders	55,1	82,2	22,6	55,8	78,9	27,2
of which						
<i>managers</i>		7,5				3,6
<i>non-managerial employees</i>		34,1	10,3		5,8	21,5
<i>former employees</i>		13,2	50,4		44,0	61,8
Ukrainian companies			19,7		6,8	8,7
Ukrainian banks	10,8	2,3	23,4	8,0	2,2	16,9
Ukrainian investment funds	0,8	0,4	1,7	0,5	0,0	1,1
Ukrainian individuals	7,3	1,7	15,5	8,8	3,0	15,9
Foreign individuals	12,7	7,2	21,6	10,8	5,8	18,8
Foreign companies	0,2	0,7	0,4	0,2	0,0	0,4
Agricultural producers	3,2	1,9	4,7	2,0	1,5	2,6
	2,1	1,6	3,1	2,7	2,3	3,5
Total	100,0	100,0	100,0	100,0	100,0	100,0

Source: Estrin–Rosevear [2003]

The role of Privatisation Investment Funds was relatively weak—this is also reflected in Table 4.5.1—and their activities were mostly restricted to trading company stocks, with little interference in the management of the companies. PIFs were unpopular in Ukraine as well as in the Czech Republic and Russia, and their closed-ended form contributed to their unpopularity in Ukraine too. In 2001 a law ordered their transformation into open-ended funds (Noel et al. 2006).

Primary and secondary privatisation—countries of slow and rapid concentration of the ownership structure

The overview in the previous section concerning secondary privatisation in five countries shows, as expected, the growth of ownership concentration and—as an “engine” of this process—the shrinking of the stakes of both the most-preferred groups: non-managerial insider shareholders and small outsider shareholders “born” in voucher mass privatisations. These ownership forms were doomed to shrink in these countries from the outset, for two reasons, as discussed in the introduction to Section 4. First, employee ownership had little support in the legal systems, weak stimuli and not much legal support. Second, the trend observed elsewhere (by other research workers) showed up in the countries studied here, too: if the protection of the interests and rights of small shareholders is weak, the ownership structure tends to be highly concentrated. Being a small shareholder is not rewarding in such countries. Whoever becomes one will eventually get out of this position.

The analysis above confirms the latter statement, but it partly also seems to deny it in an important respect. Namely, the process of secondary privatisation was (partly) slower in countries with worse corporate government systems, i.e., weaker protection of the interests and rights of small shareholders. This is surprising. One would expect that the less that small shareholders’ rights are protected, the faster they would try to get rid of their company shares. Instead, the opposite occurred. This contradiction is discussed below.

5.1 Differences in corporate governance systems

The literature on corporate governance systems (even that dealing only with systems of former communist countries) is huge; this discussion of it will be limited to recapitulating some of its main conclusions.

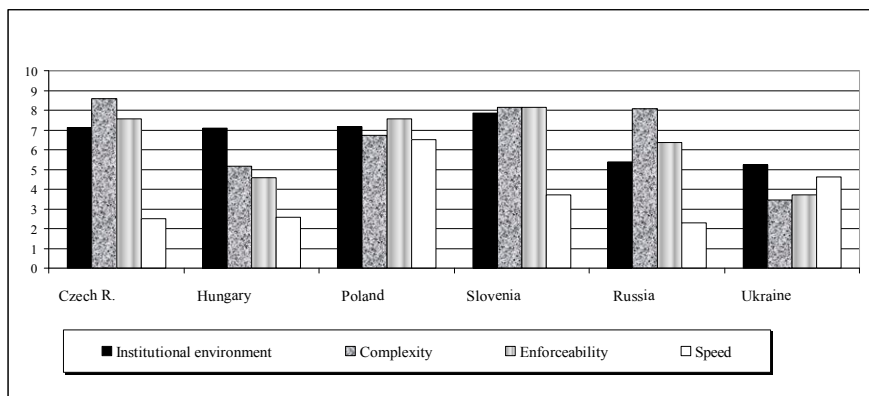
Corporate governance is typically defined as the system of guarantees of return on the investments of lenders, small owners and non-small minority owners.¹ According to Shleifer and Vishny (1996b, p. 55), “Corporate governance deals with the agency problem: the separation of management and finance. The fundamental problem of corporate governance is how to assure financiers that they get a return on their financial investment.”

Other definitions treat the issue in a wider context, referring to disclosure of information to investors, the ways in which investors can exercise their rights, and so on (e.g., Sundaram et al. 2000, and Berglöf and Claessens 2004) concerning corporate governance in transition countries.

Owners and lenders are two rather different groups of investors. Some elements of the system of guarantees are important for both; in other respects their interests are different or opposed to each other. For this study, only owners' rights and guarantees are important; the safety of lenders is not relevant here. But both sides of corporate governance systems are important here: rules set by laws and/or codes of behaviour on the one hand and enforcement patterns on the other, serving to assure the effectiveness of the rules. Enforcement tends to be the more difficult issue; it does not always follow the formal rules quickly. Formal legal rules in the field of corporate governance have been considerably improved during the 1990s in almost all former communist countries in Europe and Central Asia. In 1992 they were still much weaker than the world average, but according to a survey carried out in 1998, their average was already better than the world average. Beyond that, the indicators of quite a few successor states of the Soviet Union reached or exceeded those of Central European countries (Pistor et al. 2000). All this is not surprising. Western advisers helped formulate the relevant laws; in the former Soviet Union they were more often Americans, while in Central Europe, they were primarily experts from the European Union. Americans promoted the introduction of American rules, Europeans that of European rules; the latter are mostly (with the exception of the United Kingdom) weaker than the former. However, neither Pistor et al. (2000) nor other authors (e.g., EBRD 2004) omit the crucial importance of enforcement, its weaknesses in Central Europe and even graver weaknesses in most countries of the former Soviet Union.

¹ Usually investors with less than five percent ownership stakes are considered small owners. Thus, e.g., an investor with a 15 percent (i.e., clearly only a minority) ownership stake in a company is not “small”, and yet, he or she needs guarantees against possible abuses by another owner or groups of owners with 51 percent or more.

Graph 5.1.1 Effectiveness of disclosure of information to minority shareholders in 2005 in the six countries



Source: European Bank for Reconstruction and Development

Graph 5.1.1 displays the positions of minority shareholders in their access to information, one of the important fields of corporate governance, in 2005 in the six countries studied. In addition to formal rules (and institutional background), enforcement and the speed of disclosure of information are also evaluated and included in the graph.² Of course, the disclosure of information to minority shareholders is only one of several aspects of corporate governance, but displaying the values of other partial indicators would yield a similar picture. Unfortunately, data are lacking for the second half of the 1990s, the period most important for this study. Available sources (e.g., Blasi and Shleifer 1996; Dolgopiatova 2002; Guriev, Lazareva, Rachinsky and Tsukhlo 2003; Claessens 1995; Frydman, Gray and Rapaczynski, eds., 1996a; Claessens, Djankov and Pohl 1997; Berglöf and Pajuste 2003; Berglöf and Claessens 2004; EBRD 2004; Gregorič, Prašnikar and Ribnikar 2002) suggest that the relative positions of the countries were similar to those displayed in the graph on the basis of 2005 data, except for two countries, Russia and the Czech Republic. These two countries improved their corporate governance systems significantly: Russia gradually after the mid-1990s, the Czech Republic by leaps and bounds from 1999 on. That is, starting in the mid-1990s, these rights were

² The data come from legal firms working in European former communist countries in the field of corporate law and cooperating with the Office of the General Counsel of the European Bank for Reconstruction and Development in regularly surveying corporate governance and other legal and enforcement issues in those countries.

stronger in three of the four Central European countries studied (in Hungary, Poland and Slovenia) than in Russia and Ukraine.

And now to return to the surprising result described above: in Poland, where the system of corporate governance was better than in Russia and Ukraine, secondary privatisation was faster than in those two countries. One would expect the opposite, since the worse system of corporate governance in Russia and Ukraine should have stimulated the process of ownership concentration more. It should have compelled small shareholders to rapidly get rid of their (rather useless) stakes in companies more in Russia and Ukraine than in Poland. In addition to that of Poland, Hungary's rapid secondary privatisation, with its relatively good system of corporate governance, seems similarly anomalous in this context. But this comparison is problematic, because primary privatisation left a limited role for the secondary one in this country. The most puzzling phenomenon is the slow pace of secondary privatisation in Russia and Ukraine. Why did small shareholders not hurry to sell stakes that were of little use for them and whose sales price was at least potentially shrinking?

5.2 Once again on the differences of patterns of primary privatisation (and on why insider ownership is problematic)

We can try to answer the last question based on how dependent the speed of secondary privatisation was on the pattern of primary privatisation. As seen in Section 3, primary privatisation patterns differed from country to country. And indeed, Czech secondary privatisation was relatively rapid, not only due to the very poor protection of minority shareholders, which stimulated the sales of the problematic property stakes, but also because in this country, insider ownership was extremely limited. Citizens became owners by exchanging their vouchers for shares of Privatisation Investment Funds or directly for shares of companies. But then these owners "disappeared" rather rapidly, since they were not motivated to keep shares of companies to which they were not otherwise attached (as employees), because their PIFs were "ransacked" or transformed from closed-ended to open-ended funds, making the sale of their shares easier or, in other cases, transformed to holding companies whose limited transparency certainly stimulated the exit of their small shareholders. And many small shareholders simply forgot about their properties (there were about 1 million dormant investor accounts in the Czech Republic at the end of the 1990s).

Privatisation Investment Funds were similarly drifting towards insignificance in Russia and Ukraine too. Such gradual withering away was not possible for the Polish National Investment Funds because of their high regulation. But their owners increasingly became large investors (as seen in subsection 4.2). NIFs became one of many kinds of capital market institutions and mostly disappeared from economic analyses and documents of economic policy. Thus, in Poland, by the early 2000s, nothing really unusual for a “normal” modern market economy remained of the mass privatisation of the previous decade. The other country in which Privatisation Investment Funds were still institutions with significance was Slovenia, where the withering away of the Privatisation Investment Funds was blocked by the “privatisation gap”, the slow pace of privatisation that hindered the exchange of PIFs’ vouchers for company shares. But even in Slovenia, the legal changes of 2002 and the gradual increase in the supply of company shares offered in privatisations created the conditions, belatedly, for the withering away of the network of PIFs.

Developments following the other, insider form of preferential privatisation were rather different. Insider privatisation was the dominant pattern in Russia, Ukraine and Slovenia, and to a more limited extent in Poland. Then, in the phase of secondary privatisation, the stakes of managers increased and those of the non-managerial personnel diminished. This was an important particularity in a comparison of our post-communist manager–employee buyouts with their Western analogues. Clearly, our cases were much less concerned with saving jobs with collective sacrifices (which, as discussed in the introductory part of Section 4, sometimes manifests itself even in the temporary reduction of wages as part of such buyout deals). Thus much of what is recognised in the literature as the positive yield of employee ownership was lost. Non-managerial employees were passive owners; only managers were active, and—largely by abusing their managerial positions—they slowly expropriated the stakes of the non-managerial personnel (and possibly those of other owners). This expropriation was morally problematic. And the methods of expropriation might have been economically problematic—for instance, if profit was tunnelled out of viable firms capable of absorbing investments efficiently and used for less efficient investments elsewhere or for consumption.

And the slow pace of the expropriation might also be economically problematic. The reason for this is that managers with ambitions to become owners did not have to be good managers. Those who were not good might even have known it. But they were ready to do anything to

keep their managerial positions, because using and abusing those positions was the only way for them to increase their ownership stake. They “had to” remain managers until that stake alone was large enough to guarantee control of their companies.³ (Managers’ partial ownership under “normal” market economy circumstances is a subject discussed at length in the literature [e.g., Jensen and W. Meckling 1976, Blasi et al. 1997]. Blanchard [2006] discusses some problems of managerial ownership in transition economies.)

5.3 A finding that remains unexplained

Our analysis suggests that the gradual reallocation of property from non-managerial personnel to managers was unavoidable if the initial role of outsiders was limited: managers could exploit their positions to enhance their stakes as owners. But there were significant differences among countries in the speed at which the ownership stakes of non-managerial personnel shrank, and nothing that was said above explains these differences. The decrease of non-managerial personnel’s ownership stakes was rather limited in Slovenia, particularly at insider privatised companies and in the average of all companies (see Table 4.3.2). And we have also observed slowly shrinking average ownership shares of non-managerial personnel in Russia (see Table 4.4.1), as well as in Ukraine (see Table 4.5.1). On the other hand, in Poland the stakes of non-managerial personnel shrank quickly (see Table 4.2.4), and the sources quoted in subsection 4.2 also stressed that intra-company rules and measures aimed at hindering sales of shares to outsiders were not really efficient in Poland, whereas investigations of Russian ownership structures testify to the persistence of insider ownership, and within that non-managerial employee ownership (e.g., Filatotchev, Wright and Bleaney 1999). The assiduously high non-managerial employee ownership seems to have been specific to three countries: Russia, Ukraine and Slovenia.

³ Another problem—another weakness of the corporate governance system, relevant in at least some of the countries studied—was that even majority or exclusive owners could risk losing their property if they gave up their managerial position. This was the situation in Russia, according to Warner et al. (2005, pp. 99–101). The dilemma of the mediocre manager, as described by these authors, was to continue as a manager, with obvious unfavourable consequences, or hire a better manager and “as a rule” lose their property.

And this kind of ownership, if it is widespread, can seriously hinder the increase of ownership concentration.

Despite this book's very short treatment of the (not very significant) secondary privatisation in Hungary, this country must be included in the analysis of ownership concentration. The rather scarce available information suggests a high level of concentration that was achieved quickly. Bishop et al. (2002), analysing the ownership structure of the 162 largest Hungarian companies between 1994 and 1999, confirm this indirectly. According to the authors, in 1994 the unweighted average proportion of foreign ownership was 56 percent, and the weighted average was 44 percent. By 1999 these figures increased to 69 and 73 percent, respectively. These data suggest not only that the share of foreign ownership increased, but that foreign owners also shifted from relatively smaller to relatively larger companies. And as for concentration and its increase, the data show that foreign owners (mostly corporations) usually strive to have majority stakes if they invest in Hungary, and the data actually reflect strong majorities of foreign owners. Also, these majorities were obviously almost never held by more than one foreign owner (at least not by unaffiliated owners). Additionally, according to the authors' data, other Hungarian companies owned stakes at 60 companies, including majority stakes at 30. Unfortunately, it is not known how many Hungarian companies owned those stakes, i.e., how concentrated the ownership was at these companies. But the data show that these companies (on average) were smaller than those with foreign majority owners, and we know that the ownership of smaller companies always tends to be more concentrated; this was probably the case here too. Other sources also seem to confirm high ownership concentration in Hungary. Isachenkova and Mickiewicz (2003) compared the ownership structure of 100 Polish and 57 Hungarian large companies in 2000. They found that the average stake of the dominant owner was 70 percent at the Hungarian companies and 59 at the Polish ones. According to Earle et al. (2001), the average stake of the largest owner of the companies quoted at the Budapest Stock Exchange between 1996 and 2000 exceeded 40 percent for every year except 1998.

Table 5.3.1 has data demonstrating the ownership concentration of samples of companies quoted at the stock markets of the four Central European countries. In addition to the stakes of the largest owners, the table also shows those of the second largest owners, following Pajuste (2002), the source of the data. Pajuste supposes (not without reason) that the largest and the second largest owners usually vote together, in a coordinated way, at shareholders' meetings of Central European companies.

But regardless, with or without the second largest owners, ownership concentration is significantly weaker at Slovenian companies than at companies of the other three countries. At the latter, ownership concentration in the hands of the largest owner approximates what is observed at companies of continental Western Europe. However, stakes of the second largest owners in Western Europe are usually a lot smaller than in the countries studied, often below five percent, which means that they are not even registered (see Table 5.3.2).

Table 5.3.1 Some data of the average ownership concentration of companies quoted at the national stock exchanges of the four Central European countries

Country	Year	Number of companies	Largest owner's stake, percent		Number of companies	Second largest owner's stake, percent	
			median	mean		median	mean
Czech R.	2001	57	52,6	61,1	43	25,3	26,1
Hungary	2000	64	43,5	44,7	64	18	18,6
Poland	2000	210	39,5	44,6	210	10,4	15,6
Slovenia	2000	136	22,3	27,4	136	12	13,3

Remark: the number of companies at the second largest owners of Czech companies (43) is less than at the largest owners (57) because 14 of the 57 companies had no registered second largest owner (owners of stakes not exceeding 5 percent are not registered).

Source: Pajuste, A. [2002]

Table 5.3.2 Some data of the average ownership concentration of companies quoted at the national stock exchanges of five Western European countries

Country	Number of companies	Median value of the largest owner's stake, percent	Median value of the second largest owner's stake, percent
Austria	50	52	2,5
Belgium	121	50,6	0
Germany	374	52,1	0
Spain	193	34,2	8,9
Netherlands	137	43,5	n. a.

Remark: 1995–96 data. “0” at the second largest owner's stake means that there is no registered second largest owner (possessing a stake exceeding five percent)

Source: Becht–Mayer [2001]

This comparison can be extended to Russia, too. Table 4.4.3 displays the ownership concentration of 277 Russian companies. They were not all

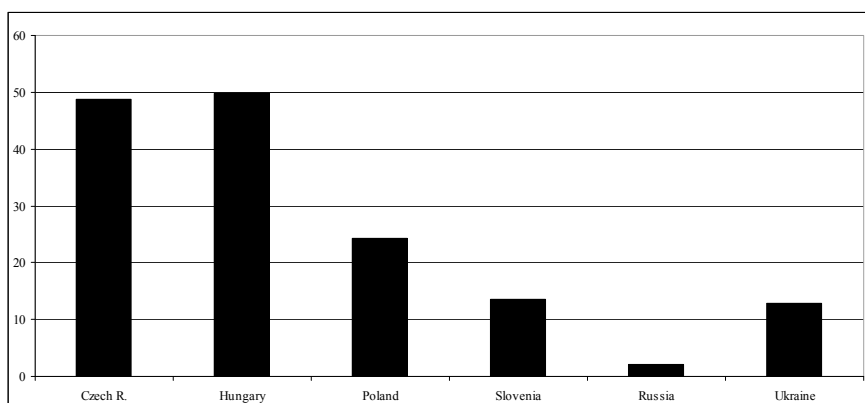
quoted at the stock exchange, and they included not only large but also medium-sized companies. Of course, the ownership concentration of medium-sized companies is always stronger in this Russian sample, which makes comparisons problematic. But even so, there is a rather low concentration corresponding almost exactly to what was seen with companies quoted at the Slovenian stock exchange.

Ukrainian data sources cannot be compared with those described above; they need to be analysed in another way. Pivovarsky (2003) has examined the concentration of the ownership structure of a representative sample of 283 medium-sized and large companies. A total of 138 of them were fully privatised; in the other 145, the state's remaining stake was less than 50 percent. Forty-six of the 283 companies had no owner with a stake exceeding five percent, and at another 91 companies the state was the largest owner. This means that at almost 50 percent of those companies in the sample that were at least half-privatised, there was either no ownership concentration, or else only the state had a large stake. For the other half of the companies no information is available about ownership concentration, except that if there were large owners, then they were at least partly connected to insiders.⁴ The analysis of the data of 270 large, mostly very large, companies in Kostyuk and Koverga (2007) also suggests that, even though ownership became more concentrated in Ukraine between 1998 and 2003, the average stake of non-managerial employees shrank only moderately, from 62 to 44 percent. At the same time, the average stake of managers grew from 6 to 17 percent and that of Ukrainian and foreign non-financial companies and banks from 10 to 31 percent, while that of individuals grew from one to 2 percent (and the state's stake dropped from 21 to 6 percent). Thus the only possible way of the observed concentration was the relatively significantly increasing proportion of companies and banks (which included insiders' companies). Managers might be majority or significant minority owners at a fraction of the companies partly openly and partly hidden behind "outsider" companies. But even this kind of concentration might not be widespread, because it was not really neces-

⁴ At 64 firms another firm was the largest owner. The sizes of these owners' stakes are not known but—according to Pivovarsky—they were usually limited liability companies established in order to hide the identity of the actual owners (who usually were connected to the firms' managers). In other words, these owners were, at least largely, insiders camouflaged as outsiders. At 30 of the remaining 82 firms, the largest owner was an individual (who might be an insider or an outsider), at 24 firms it was a Ukrainian investment fund or holding company, at 26 firms it was a foreign legal entity and at 2, it was a Ukrainian bank, but their ownership proportions are not known.

sary for controlling their companies. A voting majority at shareholders' meetings could be assured by manipulating the votes of non-managerial employees, and techniques of "self-dealing" (Djankov et al. 2005), i.e., fraudulent deals with "friendly" companies, succeeded in siphoning company revenues into managers' pockets.

Graph 5.3.1 The cumulative amount of foreign direct investments between 1989 and 2002 in the six countries, measured in percent of GDP



Source: own calculation based on the data of the European Bank for Reconstruction and Development

In summary, a level of ownership concentration basically corresponding to that of continental Western Europe emerged in the Czech Republic and Poland by the early 2000s through secondary privatisation, and in Hungary even earlier, through primary privatisation. One important detail should (again) be stressed: in Poland's case, the reduction of significant insider ownership by primary privatisation was part of this picture too. As opposed to this, in Slovenia—the fourth Central European country in this study—and in Russia and Ukraine, progress towards concentrated ownership was significantly slower. Privatisation in these three countries preferred insiders, and the structure established in this way turned out to be rather inert. The process of concentration—basically meaning the reduction of the stakes of non-managerial employees—was slow; it was primarily managers who had increasing stakes, partly in hidden forms.

An important correlate to all this is the development of foreign direct investments (FDI) in the countries studied. If a foreign individual or a foreign legal entity buys shares of a company exceeding 10 percent, it is

accounted for as FDI. This means that secondary privatisation may be FDI. Of course, by no means are all acquisitions parts of secondary privatisation, and FDI is not restricted to acquisitions: it also includes the establishment of new factories or other facilities (greenfield investments) and complementary physical investments into existing facilities (brownfield investments). Separate data on these different kinds of FDI are not available. Total FDI data are used here instead. Graph 5.3.1 shows that its amount was rather limited in Slovenia, Russia and Ukraine before 2003.⁵ The huge differences among countries displayed in the graph suggest that country characteristics play an important role in different nations' level of (inward) FDI. Many country characteristics are relevant here; this issue has been dealt with elsewhere in detail (Fertő and Soós 2008b). Here we are interested in those factors explaining the differences between the three Visegrád countries on the one hand and Slovenia, Russia and Ukraine on the other, primarily with respect to acquisition FDI, and within that more specifically FDI related to secondary privatisation.

Country characteristics influencing acquisition FDI are partly supply-side and partly demand-side factors. Supply-side factors simply refer to the availability of companies and company shares to potential foreign investors (buyers). As seen above (primarily in Section 3), all countries except Hungary applied mostly preferential primary privatisation patterns that excluded foreign buyers. In Slovenia, Russia and Ukraine, foreign buyers faced discrimination even in otherwise non-preferential privatisation sales. However, only in Slovenia were there discriminatory measures against foreigners in secondary privatisation. Of course, company manag-

⁵ There are three problems with the treatment of the Russian data. These are worth noting even though they have little or no relevance to the conclusions of this book. First, according to the data of the Vienna Institute for International Economic Studies (Hunya 2007), the cumulative amount of foreign direct investments (FDI) between 1989 and 2002 exceeded more than twice the level published by the European Bank for Reconstruction and Development (on which Graph 5.3.1 is based). However, even the Vienna Institute's data suggest extremely little foreign investment in Russia in that period; in percent of GDP, it is very modest even compared to Slovenia and Ukraine. Second, as a general rule, FDI depends negatively on the distance between the investor's seat and the location of the investment (e.g., Frenkel, Funke and Stadtman 2004, Bevan and Estrin 2004); this is an obvious negative factor for Russia (and to a smaller extent also for Ukraine) in comparison with the four Central European countries, whose direct or close neighbours are important sources of FDI. Finally, the direct source of approximately a fifth of Russian FDI was Cyprus, mostly disguising Russia or another former Soviet republic as the final source. Statistically this is also FDI, but it cannot really be considered as such. The literature (e.g., Meyer and Pind) calls it "round-tripping".

ers' efforts to hinder sales of shares to outsiders (i.e., also to foreigners) by non-managerial employees was a supply-side factor. But the Polish experience has shown that these efforts were not necessarily very effective. In other words, an explanation based on supply-side factors is not sufficient. Thus it is crucial to examine what was going on on the demand side. Did country characteristics restrict the demand of foreign investors, and more generally, of outsider investors, for enterprise shares, thus contributing to the slow pace of secondary privatisation in Slovenia, Russia and Ukraine?

6

The speed of secondary privatisation and the characteristics of political transition

6.1 Transition indicators and the quality of governance

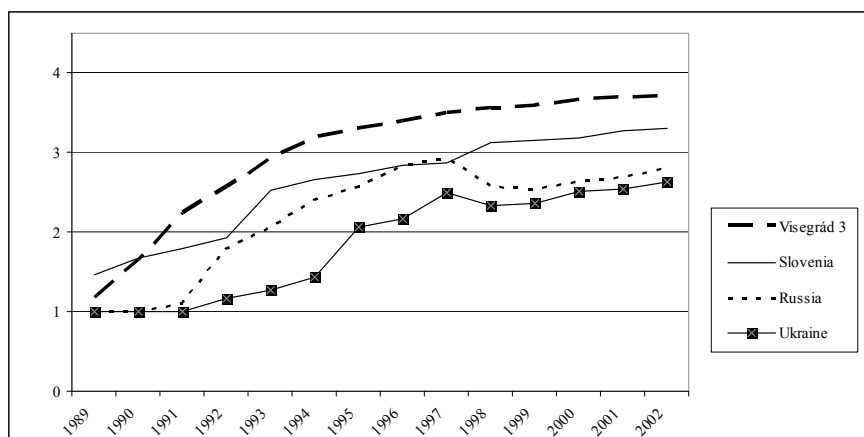
As mentioned in subsection 5.3, foreigners are mostly uninterested in having minority stakes in former communist countries' companies. If they want to be owners of companies in this part of the world, they seek a majority stake. Usually even a blocking minority (meaning, in most legal systems, a more than 25 percent ownership share) does not satisfy them. Obviously, they do not trust the corporate governance systems even of those countries in which they readily make investments. With a majority stake, they are free of any possible dangers threatening minority investors in these countries. This implies that the reason foreigners were interested in investing in one former communist country over another can hardly be inter-country differences in corporate government systems.

Domestic outsider investors' situation and attitudes are more complicated. First, costs related to distance, language and a few other factors bar many potential investors from investing abroad. If they want to be investors (in a more active and direct way than through some investment fund of their bank or the like), then they are compelled to invest in their home country. Second, they often do not have the means to be majority investors. Third, these circumstances compel them to come to know what it means to be a minority investor in their country, and they take their decisions on this basis. For this reason—with our interest extending to the attitudes not only of foreign but also domestic investors who are potential buyers in secondary privatisation—discussing here the problems of corporate governance in the countries studied might have some relevance.¹

¹ Mihályi (2004) restricts the issue of corporate governance to that of publicly traded large companies, and since such companies in this region (at least potentially) tend to be

However, most ramifications of the corporate governance issue have a limited relevance to this study. The most frequently asked question in the corporate governance literature is how managers violate shareholders' and lenders' legitimate rights to decent returns on their investments (in systems of Anglo-Saxon origin), or how majority shareholders violate minority shareholders' and lenders' similar legitimate rights (in systems based on other legal traditions). Of course, the role of the state is always part of the picture, including possible violations of—majority or minority—shareholders' legitimate rights by the state, regardless of whether the state is one of the co-owners of a company. But for this study, the latter is the only really relevant question, and the discussion of corporate governance is restricted to this issue.

Graph 6.1.1 Transition indicator scores of the Visegrád Three, Slovenia, Russia and Ukraine between 1989 and 2002—annual averages of all indicators



Source: own calculation based on the data of the European Bank for Reconstruction and Development

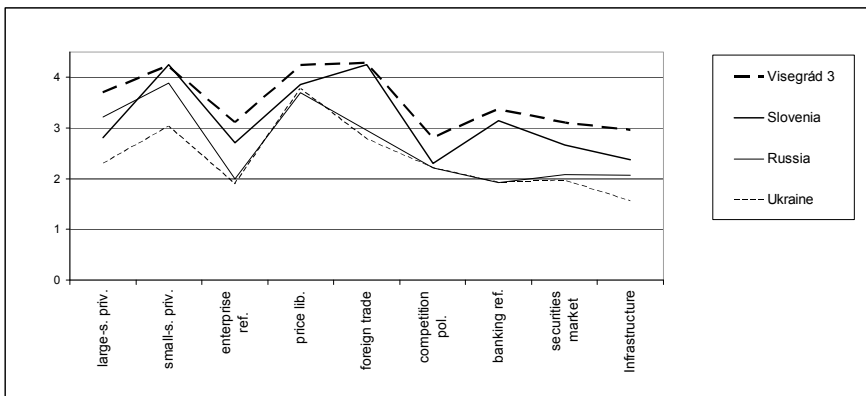
The reason for this approach is that the role of the state in these economies was huge in the early 1990s, at the beginning of the transition, and it pulled back only gradually—and not at all evenly from country to coun-

owned by foreign mother companies, he writes, even in the title of his study, about the “growing irrelevance” of the corporate governance systems of the region. We think that corporate governance is an issue whenever a company has more than one owner and/or at least one lender (which is not identical with its single owner).

try—during that decade. And the state could seriously violate the legitimate rights of the participants in the nascent market-based economic system, in ways that might be difficult to imagine in consolidated market economies.

In the countries studied, the institutional setup of the market economy was shaped only gradually. This development is quantified by the partly already cited transition indicators (with respect to the speed of privatisation; see subsection 1.2) of the European Bank for Reconstruction and Development, calculated every year for all European and Central Asian former communist countries. Their development (from 1—“representing no change from a rigid centrally planned economy” to 4.33—corresponding to “the standards of an industrialised market economy”) in the countries studied will be the point of departure here.

Graph 6.1.2 Transition indicator scores of the Visegrád Three, Slovenia, Russia and Ukraine between 1994 and 2002—average scores of nine years by countries/country group



Source: own calculation based on the data of the European Bank for Reconstruction and Development

Remark: see longer names of the indicators in the text

Nine transition indicators measure transition towards the market-based system in various fields of economic management. Graph 6.1.1 displays the development of the average scores of these nine indicators for Slovenia, Russia and Ukraine and the three Visegrád countries. (Czech, Hungarian and Polish indicators are not equal but are very close to each other. By merging them into an average, little information is lost, and the graph

becomes clearer.) There is a visible lag not only of Russia and Ukraine but (to a lesser extent) also Slovenia behind the Visegrád Three. Furthermore, Slovenia—which inherited the less rigid, slightly market-based Yugoslav communist economic system—had a much more advanced starting position than any of the other countries; but it lost its advantage rather rapidly. Then, until 1995, it followed the Visegrád Three’s gradual progress with a lag of two to three years. After 1995 the advancement of the Visegrád Three—which was already close to the maximum value of 4.33—decelerated. Slovenia’s advancement decelerated in parallel with them, at a lower level. Russia’s performance was worse than Slovenia’s but better than Ukraine’s.

Based on the visible stability of inter-country differences over time, average indicators calculated in another breakdown are also useful. They are shown in Graph 6.1.2: the 1994–2002 average performances of the Visegrád Three countries and Slovenia, Russia and Ukraine in the nine different fields of economic reforms. Russia and Ukraine had worse scores than the Visegrád Three in each indicator. Slovenia reached or approached the Visegrád countries’ scores in small-scale privatisation, trade and foreign exchange system, banking reform and interest liberalisation but lagged behind them in the other six fields (large-scale privatisation, governance and enterprise restructuring, price liberalisation, competition policy, securities markets and non-bank financial institutions and infrastructure reform), albeit less so than Russia or Ukraine.

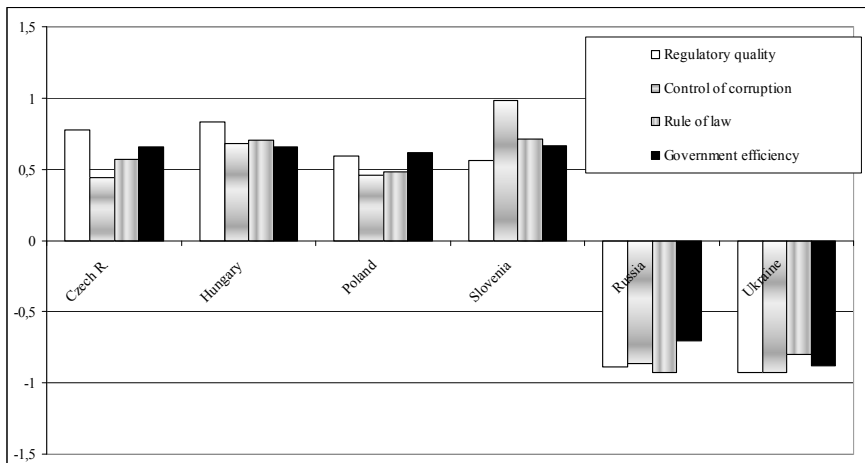
Of course, the relatively low level of development of the market economy’s institutional system may help explain the slow pace of foreign capital inflow. And it may also help explain the more general problem: that not only foreign investors but also other—domestic—investors had limited interest in becoming buyers in secondary privatisation. This explanation might work for Russia and Ukraine. However, it does not explain the low level of foreign investments in Slovenia, which, measured in percent of the GDP, equalled those in Ukraine.

Slovenia’s case becomes even less comprehensible if we compare the countries’ “quality of governance” indicator scores, as published by World Bank experts. These indicators are built by summarising the results of many different surveys of the work of the state machinery of more than 140 countries. Graph 6.1.3 shows the average scores of the countries studied here in 1996, 1998 and 2000 for four indicators: regulatory quality, control of corruption, rule of law and government efficiency.² In terms of

² We have omitted another two indicators: voice and accountability and political stability.

these indicators, Slovenia's performance far exceeded Russia's and Ukraine's, and approximately corresponded to that of the three Visegrád countries. And these indicators measure country characteristics that are no less important for foreign investors and domestic outsider investors than the above cited transition indicators. Consequently, the reason for the slow pace of secondary privatisation in Slovenia requires further investigation.

Graph 6.1.3 Four indicators of government quality—scores of the six countries (averages of 1996, 1998 and 2000)



Source: World Bank [2007]

Remark: best performers' (e.g., Germany's) scores are around 1.5; those of worst performers (e.g., Zimbabwe's) are around -1.5

6.2 Interpenetration between public administration and company management in the countries of slow secondary privatisation

The available global indicators of transition and government quality, combined with the slow pace of secondary privatisation, do not give a comprehensible picture on Slovenia. More details are necessary. In fact, some details in the field of private property rights will be sufficient. We will discuss two specific issues: the role of the government as a special kind of co-owner of companies and the non-transparent imposition of tax-type payments on companies.

6.2.1 Public administration as a minority co-owner causing uncertainty

In Russia and Ukraine (except for Western Ukraine, which was not part of the Russian Empire), there was no tradition of private ownership of land, and before the new Land Act of 2001 companies were usually privatised without the land on which they were built (e.g., Eikeland and Riabova 2002, Skyner 2001). Of course, this kind of privatisation caused critical ownership uncertainty. The state remained the co-owner of “privatised” companies in an unspecified proportion (but usually obviously with a minority stake).

The state as (usually minority) co-owner was special and problematic in another way in Slovenia: it was an active co-owner. This attitude was very different than in the other five countries under study. As will be seen below, central governments in Russia and Ukraine, and particularly local public administrations in both countries, did not refrain from interfering with the management of companies that had been fully or partly privatised. But typically they did not base their interference on their remaining partial ownership in them. (As seen in Section 3.4, in Ukraine voting rights connected to the shares remaining in state property were ceded to the company managers.) In Poland the state generally refrained from assuming the role of partial owner (except in natural monopolies and other “strategic” companies and—as seen in subsection 3.5—temporarily in the mass privatised companies). In Hungary the state as minority owner was basically passive. It only kept some important rights at “strategic” companies. And on the other hand, management rights were in some cases openly ceded to a private investor in the early phase of a gradual privatisation, when the private investor held only a minority stake. In the Czech Republic (in non-strategic companies), the state only temporarily kept ownership stakes, mainly in the first wave of voucher privatisation, in order to create reserves for the second wave and/or to sell them to strategic owners, and it was a passive co-owner.

The situation was different in Slovenia. Pezdir (2006, p. 53) pertinently writes that this country, alone in Central and Eastern Europe, applied a “more or less purely” gradualist strategy of transition, almost without any trace of “shock therapy”. The slow pace of the Slovenian transition, including slow privatisation, is often remarked on in the literature (e.g., Havrylyshin 2001, Mrkaič 2002, Rojec et al. 2004).³ Successive Slove-

³ The slow pace (or gradualism) of Slovenian reforms has extended well beyond the period investigated in this book. In 2004, the European Commission expressed concern about the lack of political commitment to the privatisation of banks (European Commission 2004).

nian governments maintained the state's strong and direct role in economic affairs. This manifested itself, aside from the slow pace of privatisation, in the active utilisation of the state's property rights, often in combination with its role of policy maker, legislator and regulator.

"(I)n Slovenia para-state funds and privatization funds act as large shareholders, despite lacking the ability and motivation for proper corporate governance." (Simoneti et al. 2004, p. 10)

"An important source of barriers to the evolution of optimal ownership structures is the combination of significant direct, and widespread indirect, residual state property in privatized companies. The state is the single largest direct and indirect residual shareholder of privatized companies. Although its shares were intended to be temporary, the state has not demonstrated much will to exit, but instead takes an active stance in governing bodies. It thus is in a position to affect secondary privatization directly through share trading, sales and purchases on secondary markets, as well as through voting in the governing bodies. Its role in secondary privatization goes even further: it is in a position to actually re-nationalize privatized property or use it in its economic policy. Its direct role in secondary privatization and as an agent of privatization (clearly favouring para-state funds) is certainly in conflict with its role of regulator, legislator and policy maker, as well as with its authority to approve takeovers and purchases made by foreign strategic investors. Substantial anecdotal evidence suggests that state representatives tend to oppose sales of controlling stakes to foreign strategic investors and hinder mergers and acquisitions." (Ibid., p. 17)

As seen in Sections 3.6 and 4.3, the state was the co-owner of (partly) privatised companies through the Slovenian Development Corporation (SDC) (whose task in principle was the implementation of privatisation) and also through the Pension Fund (PF) and the Compensation Fund (CF). A survey carried out on a sample of 227 larger companies in 2002 found that the SDC owned stakes in 45 of them, mostly less than 10 percent but often more—in one case, 63 percent. The PF was a shareholder in 111 companies. In 7 percent of the cases, it held 10 percent (exactly what it had received at the time of privatisation), in 55 percent it held stakes larger than 10 percent, and in 38 percent it held smaller stakes. The CF—as its tasks were gradually implemented—was withdrawing: it was co-owner at 136 companies, of which it held 10 percent at 38 companies, and smaller stakes at the others (Pahor 2004). These proportions demonstrate that the SDC or one of the para-statal funds alone was a significant owner only in exceptional cases, and even together they rarely might be majority owners. However, their influence was increased—aside from the dispersion of the re-

maintaining owners, seen in subsection 4.3—partly by their mutual cooperation supported by the common boss, and also by the combined application of their actions as owners with the state's role as policy maker, legislator and regulator. This “model” of corporate governance is certainly not unknown in Western market economies (particularly outside Anglo-Saxon countries), but there its application is usually restricted to “strategic” companies, and the literature of corporate governance does not deal much with it. However, in Slovenia the widespread application of this model was an important component of corporate governance. And it restricted (domestic and foreign) outsider owners, not only on the supply side (to the extent to which it explicitly aimed at preventing sales of company shares to them) but also on the demand side. Obviously, with a co-owner as ambitious as the Slovenian state, the “over 50 percent stake” principle of foreign investors could not be applied safely and efficiently (and this ground was dangerous for potential—outsider—domestic investors too).

6.2.2 Non-transparent imposition of tax-type payments on companies

The safety of property rights was also compromised in a more complicated way than the one discussed above but no less severely, by the non-transparent imposition of tax-type payments on companies. Of course, the transparency of the tax system was far from perfect in all transition countries in the early 1990s, and differences from country to country were important in this respect. However, there is a lack of data on this issue.⁴ This study will focus on informal burdens on companies that had a fiscal nature. Their fiscal nature means that they were extorted by public authorities; their informal character means that they were not based on formal legal rules, or were based on formal legal rules that explicitly contradicted other rules of higher rank. In both cases, the uncertainty of the legal system and the domination of informal relations made possible the extortions.

These extorted payments are parts of quasi-fiscal activities. Quasi-fiscality in the literature usually means artificially low price levels of certain infrastructural products and services (mainly electric energy, water

⁴ We are unaware of any cross-country comparative surveys of the predictability of companies' fiscal burdens. Only from the second half of the 1990s are data related to this issue available. The first “quality of governance” survey of World Bank experts, carried out in 1996, gave Slovenia rather weak marks with respect to the rule of law. The country's average score for 1996, 1998 and 2000, displayed in Graph 6.1.3, was favourable, but in 1996 it was only 0.47, better than for Russia (-0.90), Ukraine (-0.73) and Poland (0.42), but worse than for the Czech Republic (0.60) and Hungary (0.62).

and gas), aimed at subsidising other economic actors (e.g., Freinkman et al. 2003). However, this kind of quasi-fiscal activity is not part of this study because there is no informality here. Prices are fixed not by informal orders but by formal rules, which do not contradict other rules.

The informally extorted payments investigated here reduced companies' profits (or capital) unpredictably. But obviously, the unpredictability of these burdens was different for different (actual or potential) owners. Potential owners, particularly foreigners, had only a very limited understanding of the rules of this game, and they had little hope of influencing its course if they entered it. Actual owners (old players) understood the rules better, and they could also better influence the course of the game. On this basis, they could legitimately ask relatively high prices for their stakes. But, because yields that potential owners fearing the non-transparent extortion game could expect were more limited, they had little reason to pay those prices. Thus the system of informally extorted payments effectively reduced the demand for ownership stakes in secondary privatisation.

And now let us look at the particular kinds of extorted tax-type payments. Significant extorted payments were related to the treatment of company illiquidities. Probably nothing was more natural than the emergence of massive illiquidity crises of companies during the transition. The role of money under communism had been rather passive. Monetary processes did have some limited power in the economy, but the control over it was mostly exerted by the direct orders of the party-state machinery. And the role of money was relatively subordinated and passive; monetary processes largely only followed the movements of the real economy. Reforms introduced within the communist system strengthened the role of money, but only to a limited extent. Enterprises remained primarily bound by their plans of production, sales, etc., as ordered by the communist party and state organs. Even after the reforms, financial aspects of their activities had only secondary importance. However, under these circumstances conflicts between the system of planning and financial regulation already emerged, and they became rather serious if the reforms were relatively radical, significantly strengthening market and financial mechanisms. This was the situation after the early 1960s in Yugoslavia: the new, reformed system, with less flexible financing conditions, resulted in three decades of chronic crises brought on by enterprises' massive illiquidity. The government treated these crises by settling companies' piled-up debts from time to time, when payment turnover approached paralysis. Of course, thanks to this policy, the rate of inflation rose, reaching astronomic figures by the 1980s. I investigated these processes in an earlier book (Soós 1986).

Similar conflicts emerged in former communist countries at the beginning of the transition to the market economy, with an important difference. This time, settling company debts was much more difficult for governments. This kind of “solution” was now hindered by parliamentary control (parliaments were not necessarily against printing money and/or paying company debts from the public purse, but approval procedures could be slow and cumbersome), by the strengthening autonomy of the countries’ central banks, and also by commitments to restrict monetary growth and budget deficit taken by governments in agreements with the International Monetary Fund and the World Bank.

Of course, the problem could be treated by the application of strict bankruptcy rules. But that threatened to trigger significant unemployment; only the Hungarian and Polish governments were ready to accept those consequences. This can be seen in Table 6.2.1. (The table demonstrates that the relatively high unemployment in Slovenia had emerged as early as 1990. It was the consequence of the federal Marković government’s shock therapy and one of the reasons for Slovenia’s secession from Yugoslavia, and thus not attributable to the Slovenian government’s policies: see subsection 6.3.1.)

The Hungarian government tightened regulations for bankruptcy procedures starting in late 1991 (Wihlborg and Gangopadhyay 2001), and the bankruptcy wave started with this measure is the reason why a few authors (e.g., Hoen 1996) write about shock therapy in Hungary, which otherwise is usually described as a typical example of the application of gradualism in its transition toward a market economy.⁵

⁵ Most writings mentioning “shock therapy” in relation with post-communist transition are only political broadsides, containing little if any serious investigation and serving mainly to stigmatise professional or political adversaries. Hoen (1996) is an important exception to this rule. His presentation and contrasting of shock therapy-type elements of Czech and Polish policies and Hungarian policies are convincing. As is well-known, in Poland, in the framework of the Balcerowicz plan, foreign trade and most prices were liberalised all at once in 1989, with the simultaneous tightening of monetary and fiscal policies and the devaluation of the national currency (to the previous black-market exchange-rate level). Similar measures were implemented in Czechoslovakia, not all at once but within a short period of time, between mid-1990 and the beginning of 1991. As opposed to these countries, the “twin” liberalisation of prices and foreign trade in Hungary started in early 1989 and lasted for two years, and it was coupled with only a mild fiscal (and an even milder monetary) tightening. And the devaluation of the Hungarian forint did not exceed the pace of inflation. The Polish–Czechoslovak macroeconomic shock therapy model was not applied (nor needed) in this country. But the tightening of bankruptcy regulation starting in late 1991 represented a microeconomic shock therapy.

Table 6.2.1 Unemployment in the six countries in percent of the economically active population

Country	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Czech R.	na	na	0,7	4,1	2,6	4,3	4,3	4,0	3,9	4,8	6,5	8,7	8,3	8,0	7,5
Hungary	na	0,5	1,4	8,2	9,3	11,9	10,7	10,2	9,9	8,7	7,8	7,0	6,4	5,7	5,8
Poland	na	na	6,5	12,2	14,3	16,4	16,0	14,9	13,2	10,3	10,4	13,1	15,1	17,5	20,0
Slovenia	2,6	na	4,9	7,3	8,3	9,1	9,1	7,4	7,3	7,8	7,8	7,7	6,6	7,0	6,5
Russia	na	na	na	na	5,3	6,0	7,7	9,2	9,3	10,8	11,9	12,9	10,2	8,7	8,8
Ukraine	na	na	na	na	0,2	0,3	0,3	0,3	1,3	2,3	3,7	4,3	4,2	3,7	3,8

Sources: European Bank for Reconstruction and Development and Stanojević [2003], p. 24

In Poland, the excessive accumulation of company debts was avoided by the rigorous application of the bankruptcy law of 1934. This Polish policy was often contrasted with the example of Russia, where the existing bankruptcy law did not work in practice (e.g., Mueller 2007).

In Russia, inter-company debts became an increasingly serious problem (e.g., Aukutsionek 1998). Their piling up and frequent settlement *in natura* (which was often labelled, not quite exactly, barter, and which partly served as a tax dodge) was extensively investigated by economists (e.g., Entov et al. 2002). On the levels of regional and local governments, forcing liquid companies to subsidise illiquid ones became a more or less generally accepted practice (e.g., Yorke 2003). A study of the McKinsey Global Institute, based on surveys carried out in various Russian regions, analysed this issue thoroughly (McKinsey 1999).

The non-transparent imposition of tax-type payments on companies in Russia was not restricted to the treatment of company illiquidity. Companies were also forced by local and regional governments to sell major household consumable products at prices below cost (illegally, since by law those prices were free) (e.g., McIntyre 1998). Furthermore, layoffs (even if they were necessary to cut losses) exposed companies to various inspections and other kinds of harassments (e.g., Desai and Goldberg 2001, Kuznetsova and Kuznetsov 1999). And of course bribery was also one of the forms of non-transparent, informal tax-type payments (McMillan and Woodruff 2002).

A telling enumeration of regional economic management devices not conforming to the market economy⁶ can be found in Mau and Yanovskiy (2002, p. 330). The attitudes in relations between authorities and companies are well described by Rimsky (2005, p. 39): "In Russia not only each business but also each region has become, in fact, a client of its own administration head. Both the head and inhabitants of the region can understand these relations."

⁶ The authors examine the influence of the different regional practices of economic management on regional economic development. Their questionnaire asked about the application of various management devices typical in Russian regions, including:

- restrictions on trade margins or rates of profit;
- normative acts providing for the fixing of prices on the territory of the region, either in effect or suspended following objections made by federal authorities;
- normative requirements for agreeing on prices with consumers or the authorities, or similar procedures;
- prohibitions and other administrative restrictions on exporting products to other regions.

Regional and local governments in only a few places followed the central government's very liberal policies in 1992–1993 and even its remaining relatively liberal line until the end of the 1990s. One of those few was Nizhniy Novgorod, particularly under the governorship of Nemtsov, a leading Russian liberal politician (Borisov 2001).

Compared to Russia, Ukraine demonstrated less liberalism, even in the central government's policies. (President Kuchma's first government, established in 1994, would have been liberal, but Parliament rather efficiently thwarted its reform attempts [Aslund 2000]). Regions were weaker, vis-à-vis the central government, in Ukraine than they were in Russia. But Ukraine also witnessed the interpenetration of elites on regional levels and with it regional governments' control over the management of companies (Konitzer-Smirnov 2005, Matsuzato 2002, Birch 2000). Illiquidity crises were not as severe as in Russia. Ukrainian companies' mutual debts did not reach Russian proportions but still increased from (essentially) zero in 1991 to 13 percent of the GDP by the end of 1994. Following the austerity measures of 1995–1996, they rose to 80 percent of the GDP until the beginning of 1997 and to 100 percent of the GDP until the end of 1998 (IMF 1999). Profitable companies had to subsidise loss-making ones in Ukraine too; sometimes even the central government ordered this (Dean 2000). White's statement on Russia (2003)—that it was difficult to distinguish state property from private property there—held for Ukraine too. The security of ownership rights over companies was weak in both countries.

After the simple and readily transparent cases—Hungary and Poland on one side with rather clear and simple, secure private property rights, and Russia and Ukraine with much less secure ones—we can discuss the cases of the Czech Republic and Slovenia. In these two countries, unlike Hungary and Poland and like Russia and Ukraine, the application of bankruptcy rules was loose. But again, the authorities' tolerance vis-à-vis illiquid companies in itself is not relevant to this study. What is important here is whether central or local governments treated this illiquidity by forcing liquid companies to subsidise illiquid ones, i.e., whether the illiquidity of a part of firms also meant the non-transparent imposition of tax-type payments on other companies. This study is interested in the safety of property rights, and the subsidisation ("soft budget constraint") of loss-making companies in itself does not violate these rights. Subsidies may be granted by central, regional, or other such budgets. Of course, the revenues of these budgets were collected largely from profitable companies. However, if they were collected according to legally binding and unambiguous taxa-

tion rules (and if tax rates were far below 100 percent), then private property rights remained safe. In the opposite case, if profitable companies were forced to directly subsidise loss-making ones, then the payment obligations of profitable companies depended on the performance of loss-making companies and on ad hoc decisions of the authorities. In other words, in such cases these obligations were hardly predictable, meaning that the companies' property rights were not safe.

In Slovenia—as in Russia and Ukraine—good companies were supposed to subsidise bad ones. When the country became independent, the government withdrew (on its own territory) the shock therapy measures of the Yugoslav Marković government, among them the rigorous bankruptcy law, which had cost 600,000 Yugoslav workers their jobs (Chossudovsky 1996). A moratorium was ordered on company bankruptcies until 1994. And the mechanism of the new bankruptcy law that took effect in 1994 was very cumbersome. The government also discontinued the Marković government's stabilisation (anti-inflation) policy based on the nominal anchor of the currency's fixed exchange rate. The tolar, the new national currency, had a floating exchange rate (until June 2004, when Slovenia acceded to the Exchange Rate Mechanism—ERM II—of the European Union). The new Slovene monetary policy consisted of targeting the growth rate of the money stock. In other words, the gradual deceleration of inflation was based on the scarcity of money. This anti-inflationary instrument faced a difficult task because the (backward-looking) indexing of wages to inflation was maintained until the end of the 1990s. To dampen the inflationary impact of this indexing, money actually had to be scarce. And thus many companies inevitably became illiquid.

At the same time, economic policy makers—who remembered very well the three-decade-long history of Yugoslav illiquidity crises—understood that the consequences of monetary rigour could pile up in the banks, in the form of non-performing assets. And the level of those assets was already high when Slovenia seceded from Yugoslavia. (As seen in subsection 3.6, the establishment of the Bank Rehabilitation Agency was one of the government's first actions after independence. The agency's liquidation of banks' bad loan portfolios cost 10 percent of the GDP.) Thus, in order to avoid the accumulation of more bad loans, banks were basically forbidden to lend to companies (except for short-term, low-risk lending) (Mencinger 2004, Prašnikar et al. 2001, Mrak et al. 2002, Bojnec and Xavier 2005).

In the communist system, banks were organised as limited liability companies owned by the larger enterprises of one or more counties (and

they were informally controlled by the local communist party leadership and local governments); their primary task in those times had been to finance their owners. Their ownership structure remained mostly untouched until their privatisation (which started only at the end of the 1990s). But their tasks changed radically. A report on an investigation carried out at Slovenian companies in the late 1990s (Czaban et al. 2003) found (to its authors' surprise) that the banks, still owned by companies located in their respective counties, granted hardly any loans to those (or other) companies (on relations between banks and non-financial companies, see also World Bank [1999b]).

The circumstances described here created the most obvious foundations for local governments, forcing good companies to finance bad ones. Czaban et al. (2003, p. 16) note that good companies did not like this job, but "in Slovenia local authorities, through informal influence, do play a supportive role to some extent..."

As the authors state, their observations reflect "the continuing importance of the influence and expectations [more precisely, exactions—K.A.S.] of local authorities and local obligations on conducting business in Slovenia." Indeed, all this recalls Russia and Ukraine.

Tax authorities were also tolerant of delays in tax payments—but not from newly established companies. Only old (still state-owned or privatised) companies were entitled to pay taxes late.⁷

Of course, Slovenia differs from Russia and Ukraine (and from many other countries) in its (otherwise) advanced legal order and low level of corruption. A separate study might be devoted to the analyses of otherwise high-standard writings that did not uncover the network of state–company relations deeply characteristic of this country (e.g., Hellman and Schanckerman 2000). Martin (2008) has come closer to understanding the Slovenian regime by comparing the country to the Austrian "coordinated market model". However, what we describe here—and not only the efficient struggle against the inflow of foreign capital—suggests that the state's economic role in Slovenia was more direct than in Austria; it included

⁷ In a survey carried out at various Slovenian companies, state-owned and privatised ones mostly placed a higher priority on paying wages and salaries on time than taxes. At newly established companies, the opposite ranking prevailed. The trend noticeably excluded newly established companies from the circles of postponed payments (non-payments). But newly established companies themselves were also striving to avoid these circles: according to the same survey, they tended to require pre-payment from all their clients, whereas old (both state-owned and privatised) companies only required that from their new clients (Bojnec 2002).

significant throwbacks to the communist period (and not by chance, as will be seen in subsection 6.3).

It should be noted that the peculiarities of the Slovenian economic model described here weakened somewhat from 2003 onwards. Here again is a quote from Martin (2008, p. 136): “However [...] in Slovenia the level of coordination declined from 2003 onwards, with firms seeking increasing flexibility in wages and the use of labour.” (p. 136)

In this later period, Slovenia was already preparing intensively to accede to the European Union and also to the Exchange Rate Mechanism (ERM II), and it had to give up many of the oddities of its reforms. These developments are not analysed in this book, aside from mentioning that this country even then could not get rid of the deeply rooted tradition of inter-enterprise payment delays. According to data collected in the EBRD World Bank Business Environment and Enterprise Performance Survey (BEEPS) in 2005, from among the companies of the six countries studied here, Slovenian companies reported in the largest proportion that they had clients paying late during the previous 36 months. And the average number of such clients at those Slovenian companies was also higher than at Czech, Polish or Hungarian companies, let alone Russian and Ukrainian companies: payment discipline improved radically in these two countries after 1998.⁸

As for the Czech Republic, its bankruptcy mechanism in the 1990s was as weak, bureaucratic and cumbersome as Slovenia’s (Wihlborg and Gangopadhyay 2001). However, this did not entail the subsidisation of bad companies by good (non-bank) ones. The literature available to us includes only one article describing inter-company debts as a problem in the Czech Republic (which was severe in 1991 and worsened again in the second half of the 1990s). However, this source notes that even in the latter period, the main problem was companies’ indebtedness to banks and, within that, a high share of bad debts—from the point of view of the banks, bad loans (Schönfelder 2001) (in line with what subsection 3.2 says about the difficult position of banks, which were lenders to companies and largely also their owners through the largest Privatisation In-

⁸ Eighty-four percent of Slovenian companies had clients paying with a delay during the last 36 months before the poll. This proportion was 44 percent at Russian companies and 55 to 59 percent at companies of the remaining four countries. Those Slovenian companies had on average 31 clients paying late. On average, Russian companies reported five clients, Ukrainians and Polish nine, Hungarians 14 and Czech companies 19. Source: author’s calculations based on <http://www.ebrd.com/country/sector/econo/surveys/beeps.htm>.

vestment Funds). Winiecki (1994) suggests that the level of debts between non-financial companies in the first half of the 1990s was similar to the (modest) Hungarian one. Later investigations (Kolodko 2001, Hildebrandt 2002) also confirm the primary role played by the banks in this field: under the conditions of loose prudential regulation of the banks' operation, the state-owned banks (which through their Privatisation Investment Funds also were shareholders of many companies—see subsections 3.2 and 4.1) provided financing for loss-making companies until the end of the 1990s. Then the exhaustion of the banks' sources compelled the government to restructure the banks (at public expense) and privatise them. The role of the banks in financing bad companies basically exonerated good companies from the same task. Banks financed company losses in other countries during the first years of transition; the Czech case—which King (2001) called “financial clientelism”—was just an extreme one.

What was the reason for the banks' behaviour? Inability to resolve the conflict of interest (see subsection 3.2) emerging from their dual position as owner and lender? Or corruption? Or pressure from the government, which wanted to avoid an increase in unemployment? All three were probably factors; it is impossible to say for sure. Klaus, who was prime minister until December 1997, made (failed) attempts at privatising banks. These efforts would suggest that Klaus—as he explicitly declared—did not deliberately compel banks to finance company losses. But later pronouncements of company and bank managers did not confirm this unambiguously (Appel 2004, p. 63).

6.2.3 Interpenetration between public administration and company management and the soft budget constraint

This analysis has found that a concentrated ownership structure of companies essentially corresponding to the relatively poorly developed system of corporate governance in Hungary was practically created already in primary privatisation. This was not the case in the other five countries. In two of them, the Czech Republic and Poland, secondary privatisation brought about a structure fundamentally similar to the Hungarian one rather quickly. However, in the remaining three countries, Slovenia, Russia and Ukraine, the mechanisms of secondary privatisation worked rather slowly, and a concentrated ownership structure did not develop by the end of the first decade of transition.

This study has found a relationship between the pattern of primary privatisation and the speed of secondary privatisation. The ownership struc-

ture created by voucher mass privatisation melted more quickly, whereas insider privatisation was more resistant to change. This helps explain the supply side of secondary privatisation: insider owners (non-managerial employees) were less willing to sell and were also hindered from selling their ownership stakes. However, this study has found this explanation insufficient, and complemented it with two factors that significantly impaired the demand side in secondary privatisation. Namely, we have investigated in which countries the state became a minority co-owner of private investors causing uncertainty in ownership rights, and in which countries companies were subject to the imposition of non-transparent tax-type payments. We have discovered both these phenomena in the three countries of slow secondary privatisation.

Both phenomena emerged in (partly) different forms in Slovenia on the one hand and in Russia and Ukraine on the other. As seen earlier, the state's role as co-owner caused uncertainties in ownership rights in different ways in Slovenia and in the two former Soviet republics; "only" the consequence—the uncertainty of the property rights of private majority owners—was the same. It is even more important to underscore the difference in the non-transparent imposition of tax-type payments on companies. In Slovenia, it was restricted to compelling good companies to finance the losses of bad ones. In Russia and Ukraine it also had other forms: illegal price fixing and corruption, which in these countries were rather widespread.

Yet all these phenomena, despite their differences, had a common denominator: the interpenetration between public administration and company management. Furthermore, this interpenetration is clearly related somehow to the public subsidisation of companies, i.e., the phenomenon (or more precisely, the most important of the phenomena) that used to be labelled, after Kornai, soft budget constraint (Kornai 1980).

However, the soft budget constraint was not, and could not be, a particular feature of only some countries in the first period of transition. It was, and had to be, paramount in early transition. Companies' budget constraints had to be soft simply because at that time, in all transition countries, the banking system and the capital market in the usual sense of these words were non-existent. There were no banks or capital markets that would have assured, smoothly and reliably, the supply of credit and equity capital for profitable companies. Banks (before the entry of foreign banks' subsidiaries) were usually formed from different divisions of the former "monobank" of each country: in the communist system, one bank essentially financed the whole economy, and its operation was based on

the government-prepared plan of production, exports, imports, investments, etc. The monobank did not have to worry much about the profitability or the liquidity of the companies; if its loans were not repaid, that was not a big problem. There was little or no difference between financing by bank loans or budget subsidies. Transition started from this system, i.e., the newly formed banks did not inherit from the monobank any expertise in lending to companies in a market economy. The banks' operation inevitably remained highly politicised for a long time. Aside from politicised operation, they inherited huge amounts of non-performing assets.⁹ The high level of such assets and (under the conditions of the economic recession experienced in the first years of transition) the slow or negative growth of household savings meant that the banks had very limited opportunities for new lending to companies. And because of the banks' politicised operation, even those few new loans could be considered subsidies rather than loans.

It should be noted that, in the economies of transition countries, these and other government subsidies were absolutely unavoidable. Companies anywhere in the world cannot operate without the availability of external financing. Hicks (1974) writes about the importance in the capitalist system of companies being able to borrow. He states that even good companies often face temporary, unforeseen losses; they cannot keep monetary reserves for such cases, but they can always borrow from banks. Since banks in that usual sense did not exist in the early transition, transition economies without government subsidies would have been (for some years) similar to the US economy in the days following the collapse of Lehman Brothers in September 2008. Thus in the early transition (and of course, also before that, in the communist economy), nothing was more natural than subsidising companies, i.e., the soft budget constraint.

Of course, the lack of banks in the usual sense of the word and of capital markets would only have justified subsidising companies that would be profitable in the long term. But—as discussed in subsection 2.1—governments' economic decisions are never motivated only by considerations of profitability, and government subsidies can be granted, with or without the fig leaf of profitability considerations, to any company for any purpose.

Thus, in the early phase of transition, the softness of companies' budget constraints was prevalent in all the countries under study here. The

⁹ These problems, and the slow emergence of a modern banking industry in transition countries, are analysed in, e.g., Bonin et al. (1998).

interpenetration between public administration and company management—which was observed in only three of the six countries—might have an impact on specific forms, kinds and extent of the softness of the budget constraint (if this size can be defined and measured), but it was not the reason for the softness.

6.3 Soft political transition and interpenetration between public administration and company management

Significant differences separate Central European countries from former Soviet republics. Thus it is no surprise that this book contrasts the group of the Czech Republic, Hungary and Poland with Russia and Ukraine. But is it correct to place Slovenia in the second group, rather than the first?¹⁰ Well, in Slovenia, unlike in the other three Central European countries and like in Russia and Ukraine, close ties between public administration and company management were not cut. Let us see why and how.

6.3.1 The Slovenian political transition (and some short remarks on Slovakia)

In Slovenia's political transition from communism to democracy, the official communist-led youth organisation played a very important role, and the better understanding of the transition process requires some explanation of this organisation's status. Its name was the Socialist League of Youth (SLY). Formally it was one of the constituent organisations of the Yugoslav Socialist League of Youth (along with the corresponding organisations of other Yugoslav republics). Like all other political organisations in communist countries, the SLY was rigorously controlled and micro-managed from above. However—like for all political organisations in communist countries, except of course the communist party—the controller from above was not the upper level of the organisation itself (i.e., in this case the Yugoslav Socialist League of Youth) but the corresponding organisation of the communist party, in this case the League of Communists of Slovenia (LCS), the Slovenian division of the League of Communists of Yugoslavia.

¹⁰ A cluster analysis of institutional development in Weder (2001) places Slovenia and the other Central European countries in the same group.

The roots of political transition in Slovenia go back to the 1970s, when various unofficial, mostly non-political youth groups came spontaneously into being. Such initiatives were stronger in the Socialist Republic of Slovenia than elsewhere in Yugoslavia, and the SLY heretically took a tolerant attitude towards them. It later even established contacts with such groups (no other official political organisation did anything similar in Yugoslavia). Of course, the LCS's relatively liberal approach to controlling the SLY was a crucial factor in the latter's "unbolshevik" behaviour. The actual beginning of political transition might be dated to 1986, when the SLY formally declared its independence from the LCS. The Belgrade leadership of the League of Communists of Yugoslavia demanded the most rigorous retribution from the LCS for this outrageous behaviour. The situation gave rise to grave conflicts within the LCS, but they ended with a victory for tolerance. The liberally minded Milan Kučan was elected as the party's president (later, between 1990 and 2002, he was president of independent Slovenia, in a multiparty system). And the SLY became a force that was not really an opposition but also not (yet) a governing political party, under the name "Liberal Democracy of Slovenia."

Besides the SLY's emancipation affair, other controversies also developed between Ljubljana and the Belgrade federal leadership. One of them was related to the financial support to the poorer republics of Yugoslavia. The economically more developed republics—among them the most developed, Slovenia—had disputed the efficiency of the support system for decades. When, from the early 1980s onwards, economic growth ceased, and the support had to be provided from the shrinking tax revenues of the Slovenian budget, it became a highly delicate issue. After the death of Tito, the founder and high-handed president of communist Yugoslavia in 1980, nationalism strengthened in the party-state machineries of all the republics. The federal leadership—increasingly considered Serbian everywhere outside Serbia—took actions clearly aimed at increasing tensions.¹¹ In 1990, the League of Communists of Slovenia withdrew, for all practical purposes, from the League of Communists of Yugoslavia. The desire to secede from Yugoslavia was strengthening. People did not expect that a declaration of independence by the ethnically almost-

¹¹ For instance, in 1988 the Yugoslav People's Army's plans for military operations against Slovenian "alternative" social movements (various punks and environmentalists, all of whom had good relations with the Socialist League of Youth) were leaked in Ljubljana, Slovenia's capital. The alleged perpetrators were tried and sentenced in Ljubljana by a military court, in the Serbian language.

homogeneous Slovenia would lead the federal government, which depended on the support of international financial organisations, to launch a war. Slovenia declared independence in June 1991. The Yugoslav People's Army left the country after a war that lasted 10 days and cost 200 lives. The long fight, including the short war, for independence created a relative national unity in Slovenia. The enemy was Belgrade, rather than the communists who played a crucial role on the Slovene side. The first free parliamentary elections were held in April 1990. The League of Communists of Slovenia lost, but the liberally oriented communist Kučan became head of state, and the Liberal Democracy of Slovenia, i.e. the former communist youth organisation, became the strongest party in the nine-party government coalition (starting at the end of 1991, they provided the prime minister). (See Fink-Hafner 1997, Bukowski 1999 for more detail).

Drahokoupil's explanation (2008, p. 179) of the peculiar Slovenian political development is that this country "had a long record of relatively successful reforms implemented by the Socialist Party".

We are not aware of any other reforms implemented by Slovenian communists than the courageous political moves described above. In particular, the Slovenian communist leadership did not do anything to liberalise the communist economic system. On the contrary, one of the reasons for Slovenia's secession from Yugoslavia was its opposition to the liberal reforms of the federal Marković government.

As the secession established relative national unity, no political cleansing was implemented in the government machinery and among enterprise managers. Furthermore, the network of formal and informal relationships survived the changes in the top political positions entailed by free elections, and of course, the ways and routines of functioning also survived. Mencinger, who was deputy prime minister from 1991 on, wrote that the "old-timers" adapted to the new circumstances.¹² Many other authors also stressed the positive side of this method of political transition but still considered it problematic. They mentioned, for instance, that the search for consensus between the old and the new elites hindered any radical reforms

¹² "(T)he members of the former elite became an ally of the emerging civil society against the Yugoslav authorities [...] no revenge was taken on them, and [...] they adapted so quickly and successfully to change. Also, the former economic elite (that is, the enterprise managers) retained or even strengthened their position in society. The coalition of the two elite groups ensured the exchange of economic and political support and enabled both to become the winners in the transition process" (Mencinger 1994, p. 76).

(Ovin and Kramberger 2004, Kramberger and Vehovar 2002); that reforms to curtail the old elite's privileges were coming too slowly (Adam and Tomšič 2002); or that the old elite, including company managers, exploited their experience and knowledge to hinder institutional changes, rather than to support faster changes and development (Šušteršič 2004). (See also O'Donnell [1998] and Iglie and Rus [2000] on this widely debated issue.) Despite the criticisms, in practice no one attacked the compromise with the old elite; searching for compromises and consensus became the basic principle of political and economic management in Slovenia.

Croatia, the neighbouring former Yugoslav republic, underwent radically different processes. There, secession from Yugoslavia was managed by a newly emerged, pointedly anticommunist party, the Croatian Democratic Union, rather than by young and liberally oriented communists. Consequently, the issue of enterprise managers inherited from communism became a hotly debated one (irrespective of whether they were Croats).¹³ And, from 1992 onwards, the government took measures to restrict managers' opportunities to acquire ownership stakes in their companies (Babič 1990).¹⁴

Differences similar to those described here between the Slovenian and Croatian political transitions and the related treatment of former communist enterprise managers were also revealed between former Soviet republics, with similarities appearing between Slovenia, Estonia and Latvia on the one hand and between Croatia and Lithuania on the other.¹⁵

And at this point, it is worth looking at an analysis in Appel and Gould (2000) of political developments in Slovakia. At the beginning of Czecho-

¹³ The treatment of former communist enterprise managers in the two new countries was radically different. Yet the professional level of enterprise managers in both countries was higher than the mean level in Central Europe (Warner, Edwards, Polonsky and Zhu 2005).

¹⁴ Measures taken in 1992 were still only aimed at stimulating those who, as insiders, had obtained ownership stakes to keep them. The purpose of these measures was to thwart managers' efforts to purchase workers' stakes. Later, in 1996, opportunities for insider privatisation were abolished (see Lowitzsch et al. [2006]). With this change, privatisation revenues increased, helping fiscal consolidation. But this provision was partly also aimed at weakening the positions of company managers.

¹⁵ According to Steen (1997), the share of persons who had been in high positions during communism was higher in the Estonian and Latvian elites (54 and 55 percent, respectively) in the mid-1990s than in the Lithuanian elite (44 percent). Steen's explanation for this difference is that in Lithuania, political affinity was considered more important for staying in or being appointed to elite positions, whereas in the other two new Baltic countries, nationality was more important.

slovakia's transition, the new Czech leaders' radical anticommunism dominated, leaving former communist enterprise managers in a very limited role (see subsection 3.2). But the Slovak political leadership's first priority was getting rid of Prague, rather than of communism. This priority led to Slovakia's independence after January 1993, radically improving the positions of company managers. Among other things, the second wave of voucher privatisation was cancelled in Slovakia, and privatisation methods more advantageous for company managers were introduced instead. According to Appel and Gould (2000, pp. 112 and 120):

"Slovak managers found a useful resource in national identity to help reinsert themselves into the political decision-making process. In contrast, efforts by Czech managers to gain greater control over policy-making were thwarted by Czech government leaders whose aggressive use of anti-communist, pro-European rhetoric dominated discussions on post-communist identity and kept managers on the political defensive both before and after the division of Czechoslovakia. ...

"As Slovak politicians began competing along national lines following the Velvet Revolution [which overthrew communist rule in Czechoslovakia in November 1989—K.A.S.], the Prague-centric nature of both the federal institutional framework and the prevailing conception of transition came under fire from a wide spectrum of Slovak social and political leaders. Former Slovak communist managers used the space opened by this political debate to re-insert themselves into the political process."

These short remarks on the Croatian, Baltic and Slovak political transitions towards democracy, coupled with the analysis of the Slovenian one, seem to modify and supplement the conclusions drawn by Beck and Laeven (2005, pp. 34–35) that "reliance on natural resources and the years under socialism explain variation in the degree to which former communists were able to retain power and the degree of political openness at the beginning of the transition process".

Namely, transition from communism to a democratic system coincided in quite a few cases with the establishment of new nation-states. These nascent countries were governed in this double undertaking by primarily anticommunist or nationalist political forces. If the latter was the case, it enhanced former communists' ability to retain power (and reduced the degree of political openness).

Of course, our remarks concerning some other countries only serve to strengthen the argument about Slovenia. This country's soft internal political transition (which was naturally connected with the external conflict accompanying its secession from the Socialist Federal Republic of Yugo-

slavia) explains the survival of former routines and formal and informal relations in economic management. What we see here is not simply a high share of former communist enterprise managers keeping their positions in the 1990s. A political transition of the opposite kind can assure a not much smaller “survival rate” of the enterprise elite, even though in another way (see below). More importantly, we can observe here the survival of old routines, old rapports of economic management, and the survival of the interpenetration between public administration and company management. Furthermore, former roles did not remain unchanged. The end of control by the communist party, the managers’ new ownership stakes and the achievement of real autonomy by their associations (which also emerged from party control, and even received some role in high-level political decision-making¹⁶) caused previously hierarchical rapports between public administration and company management to become more like mutual dependence. Adam et al. (2008, p. 52), comparing Slovenia with Estonia, describe the positions and connections of the two countries’ elites as follows:

“Estonia is characterized by (neo-)liberal elitism where interest groups are relatively weak and political influence is thus exercised on a predominantly individualist basis, i.e., by the people who possess enough financial and social capital to establish connections with the key policy-makers, while in Slovenia a (neo)corporatist elitism involving the overlapping and interlocking of political and non-political elites prevails...”

6.3.2 The Russian and Ukrainian political transitions

The basic trends of political transition in post-communist Russia moved even more clearly in the same direction as in Slovenia. According to some authors, the power of company managers, once restrained by communist party control, became unlimited as they acquired significant ownership stakes in their companies (e.g., McFawl 1995). However, this proposition, in such an extreme form, held only for the very thin layer of “oligarchs”¹⁷ in 1990s, i. e. in the Yeltsin era, and not even for them later, under Putin’s presidency. And the tens of thousands of managers of medium-sized and even large companies never attained such “royal” status (e.g., Guriev and

¹⁶ The National Council, a corporative body, functioned in practice like a second chamber of Parliament, in which employers’ associations played an important role (e.g., Fink-Hafner 1998).

¹⁷ See footnote 8 in subsection 4.4.

Rachinsky 2005). Their positions did strengthen—with their strong positions in Parliament, they achieved the approval of a privatisation policy and law radically different from the government's original intentions (see subsection 3.3).

However, the regions (i.e., oblasts, republics, krays, and so on—the 89 “subjects of the Russian Federation”), whose role strengthened (e.g., Poletaev, ed., 2000; Konitzer-Smirnov 2005), became the main arenas for relations between public administration and enterprises. As a reaction to the reform efforts of successive, fairly liberal federal governments, regional resistance to changes from above, an old tradition in Russia, emerged. The literature usually describes Russian regional and local elites as groups of the old *nomenklatura* safeguarding their power,¹⁸ whose ways of operation changed in many respects,¹⁹ but who did not give up the close control of “their” companies. Changes in political leadership and the civil service were much more limited at the regional and local levels than in the federal government. (Szelényi and Szelényi [1996] indicate that even by the end of the communist period, there was only a tiny oppositional elite in Russia. Consequently, there were few who could replace regional elites.)

Newcomers entered the political elite, but they usually adapted to the old norms. Regional and local elections changed the political allegiance of top leaders of regional and local administrations, but they seldom brought about any deep changes in economic policies. For example, when Zhirinovsky's populist, but in many respects still pro-market, Liberal Democratic Party won the elections in the oblast of Pskov, its new government implemented, with rigorous consistency, a policy of regional economic autarchy. For example, by introducing an “adequate” kind of quality control, they kept vodka produced elsewhere (in Russia or abroad) out of the region's market (Darrell 1999). Such autarchy was widespread in Russian regions in the 1990s (an excellent analysis of this can be found in McKinsey [1999]).

If the political transition in Russia can be considered soft, then this is even more true of Ukraine, where a government consisting of non-

¹⁸ For example, in the Far Eastern region of the Primorskiy kray, “(t)he regional elite consists of former *nomenklatura* members of state and party structures, including representatives of industrial management and the military” (Kirkow 1995).

¹⁹ Glatzer (2003) summarises the debate on change and continuity, and investigates the example of the operation of local power groups through the example of the Tumen' oblast.

nomenklatura intellectuals never came into being (President Kuchma's liberally minded government, established in 1994, consisted of former high-level *nomenklatura* people). The share of former Soviet *nomenklatura* position holders diminished only very slowly and gradually in the governments, and more generally in the Ukrainian elites (Nastych 2003). Thus regional elites did not have to defend non-market mechanisms against the central government's reform fever—because there was no such fever. Ukraine also differed from Russia because of the fluctuating importance of Ukraine's regions in political and economic decision-making during the 1990s, depending on the changing strength of successive presidents vis-à-vis Parliament's efforts to decentralise power. However, regional factionalism in Ukraine has strong roots. Most of Ukraine historically belonged to the Russian Empire, but some regions were parts of Poland, Hungary and other countries. On the basis of these and other—ethnic and economic—differences, experts usually divide the country into eight regions (e.g., Barrington and Herron 2004). Insight into the mechanisms of regional power, into the role played in them by managerial groups, is provided by an analysis of elections to the city council of Mykolaiv, a large city in southern Ukraine, in 1994, 1998 and 2002. The share of council members elected from various groups participating in power (e.g., local executive power, political parties, NGOs) fluctuated, except for the managers of large enterprises located in the city: they firmly held a quarter of the seats. This reflects their important influence in local politics and with it the strong relations between political and economic elites (Yatsunka 2003, Simon 2001).²⁰ Such political structures assured the survival of old routines in economic management, the interpenetration between public administration and companies.

The importance of regionalism both in the huge former Soviet republics of Russia and Ukraine (discussed in this subsection) and in tiny Slovenia (discussed in the previous one) might seem strange. But in both cases, it was part of the legacy of communism. Regional power structures (then as transmission devices of central power, rather than as autonomous sources of it) played important roles in the communist period both in the Soviet Union and Yugoslavia. The importance of the regional level in the Soviet Union had a double foundation: first, the country's huge size required a strong intermediate level of the party–state machinery, and second, that level did not have to be the national republics, because national factionalism had to

²⁰ Simon (2001) attributes a fundamental importance to such relations in the economic and social settlement of Ukraine (and Russia) in the 1990s, in hindering radical reforms.

be avoided. The first of these factors was non-existent in Yugoslavia, but the second one was no less relevant there than in Russia. More precisely, it was no less relevant until the early 1970s, when the role and autonomy of national republics in Yugoslavia started to strengthen. However, this strengthening (which ended in the disintegration of the country and even some wars among its successor states) did not entail any significant cutback of the quarter-century-old regional power structures.

6.3.3 Hard political transition and the end of interpenetration between public administration and company management

In Russia, Ukraine and Slovenia, the significant role played by regional public administration in the transition period was a legacy of the communist period. In the communist period, there was another, even more important regional control over companies: control by the communist party's regional committees. Control by the party and by public administration were not really separate: local party bosses were also members of the decision-making bodies of public administration, and vice versa. Thus, with transition, the party control disappeared, but even in the formal sense, that implied only partial changes in power relations. An important difference between these countries and the Czech Republic, Hungary and Poland was that in the latter three, in the communist period regional control over companies (aside from very small or infrastructural ones) was fundamentally only party control. State control was not regional, let alone local. Companies' basic contact points with the state administration were (national) sectoral ministries. When the communist party's regional committees lost control of these not-insignificant companies, that control could not be asserted by the regional public administration. The latter never had control over such companies and was simply unprepared to take it. And of course, earlier control functions of party committees could not be assumed by sectoral ministries. This difference between the two groups of countries had a role—but not a decisive one—in the different fates of the interpenetration between public administration and company management in them.

The decisive difference between the two groups was that the three Visegrád countries had a hard political transition, i. e., a break with the communist past. Of course, many people in these countries would not agree that there *was* a break. Former communist leaders were not sent to emigration or worse, so, according to some people, there was no break. But the discussion of the issue in this book is restricted to a comparison with transition in Slovenia, Russia and Ukraine. And, unlike in those

countries, in the Czech Republic, Hungary and Poland the transition to democracy started with anticommunist parties establishing new governments. This is what is meant here as a break, as a hard transition.

This break entailed a radical disintegration of former systems of political-administrative contacts and ways of operation. Top posts of the government machinery were occupied by ministers coming from outside the highest positions in the former party and government. They took their positions promising to fight the power of the former *nomenklatura*. They were not radical in doing what they promised but, because of their political commitment, mutual contacts between them and old company managers could seldom be confidential even in the—rather rare—cases when they also had previously been company managers or directors, or deputy ministers in the communist period. The informal control over companies that played an important role in the communist system (Soós 1986 and Soós 1987a) largely dissipated, even before the widespread privatisation of companies.

The issue discussed here—the degree to which former informal rapports survived, and the related methods of operation during the first decade of transition, including after the first steps of privatisation—is related to the destiny of the elites of the communist period. The latter has been investigated by sociologists. As mentioned above, *nomenklatura* elites largely kept their positions in Slovenia, Russia and Ukraine. But research has found that high proportions of former members of *nomenklatura* elites became members of the new elites in the three Visegrád countries too (e.g., Mertlik 1996, Staniszkis 1991).²¹

Subsection 3.2 found that the Czech privatisation limited but did not close off such opportunities for communist managers. And the Hungarian solution, selling primarily to foreigners, also left such possibilities: these managers were helped by their relational capital (Hankiss 1989), even though under the given circumstances this relational capital might be limited to relations to other business leaders and not include similarly good relations to the new political leadership. Besides relations, Szalai (1993) also stresses professional competence as an important factor in the survival of the “new technocracy”,²² whose members in the transition period were largely re-

²¹ This is also confirmed by Laki (2003). He finds that two groups of new (domestic) owners are numerous in Hungary: former (communist-era) managers of large companies and small entrepreneurs of the 1980s.

²² The emergence of the “new technocracy” is analysed by Lengyel (undated). A survey of 1998 (Ilonszki and Lengyel 2007) demonstrated that company managers from that period had typically received their first such posts in the first half of the 1980s. Lengyel (2003) analyses this and the deceleration of the change of the elites in the first half of the 1990s.

tained in their positions even by new foreign owners, partly but not solely on the basis of their relational capital. Of course, technocratisation in the 1980s was not restricted to Hungary,²³ and with it many company managers remained fairly successful in their jobs in the years of transition.

To simplify a bit, while soft political transition created one opportunity for communist-era company managers to keep their managerial positions, hard political transition left open another option—although, as the “survival rates” cited above demonstrate, the latter option was a more difficult one. A higher percentage of the old elite remained in power in Russia and Slovenia than in the three Visegrád countries (data for Ukraine is not available).

Data stemming from various investigations usually reflect the staying in power or occupation of a new position not only of company managers but, more generally, of the communist period’s elite or of its higher (at least county level²⁴) *nomenklatura*. But the analysis is often broken down by (old or new) positions.

Table 6.4.1 displays, on the basis of a representative survey, the social positions in 1993 of the members of the Hungarian, Polish and Russian *nomenklatura* elites of 1988. They were classified as belonging to the elite in 1993 if they were directors of large companies, or if they were in jobs where they could make political or cultural decisions of national importance. According to the data, the proportion of those remaining in the elite was more than three times higher in Russia than in Hungary, and the Polish figure was closer to the Hungarian than to the Russian one. At the same time, the share of those members of the 1988 *nomenklatura* who, in 1993, worked without subordinates or were retired was a lot higher both in Hungary and in Poland than in Russia.

According to investigations carried out in the Czech Republic and Slovenia (unfortunately by different teams and possibly not with comparable methods), 40 percent of the Czech economic elite of the 1990s²⁵ had held elite positions in the communist period; in Slovenia, this figure was 84 percent (Adam and Tomšič 2002).

²³ For instance, according to Machonin et al. (undated), Czech managers well understood in the 1980s the need for radical changes in the Czechoslovak economy.

²⁴ At least county-level *nomenklatura* means those positions (and people occupying those positions) that could only be filled with the approval of the county party committee or a higher party body. Managers of medium-sized and large companies belonged here. (See footnote 3 in Foreword and overview.)

²⁵ The authors used the words “forty per cent of the Czech transitional economic elite” without specifying the year of the survey (Adam and Tomšič 2002, p. 451).

Table 6.4.1 The social positions in 1993 of the 1988 *nomenklatura* on the basis of a representative survey

Position in 1993	Hungary	Poland	Russia
Elite	20	38,2	64,2
Non-elite, working with subordinates	31,5	18,4	15,5
Non-elite, working without subordinates	15,7	16,6	10,6
Retired	32,8	26,8	9,7
Total (percent)	100	100	100
Total (n)	662	888	854

Source: Szelényi–Szelényi [1994]

A deeper change of the elite in the Czech Republic, Hungary and Poland is also reflected by the fact that the examination in the 1990s of elite groups' former contacts with the communist secret police was more rigorous there than in any other former communist countries (except the former East Germany) (Williams et al. 2005).

Among all the changes in relations and behaviours, the key question was whether the network of political power broke down (as in the Visegrád countries) or did not break down (as in Slovenia, Russia and Ukraine) at the start of political transition, rather than the percentage of the elite remaining in elite positions. But these percentages also reflect the important differences in political—and then in economic—transition.

Conclusions

7.1 Privatisation and the character of political transition

This survey of primary and secondary privatisation in six countries until the early 2000s has observed that the character of political transition had a considerable impact on secondary privatisation and a somewhat weaker one on the methods and speed of primary privatisation.

Political transitions showing strong signs of continuity in Slovenia and Ukraine were followed by slow primary privatisation. At the same time, Russia, another country with soft political transition, had a rapid privatisation of a large share of its economy. And as for privatisation methods, on the basis of the problems with pure sales described in subsections 2.2 and 2.3, preferential solutions were applied everywhere on a large scale. Hungary applied such devices least frequently, but this (and the high share of sales to foreign strategic investors) was partly due to the state treasury's severe indebtedness. However, insider privatisation was restricted in Hungary and Poland, and was for all practical purposes nonexistent in the Czech Republic. This distinctive feature of the three Visegrád countries was obviously related to fact that these countries had hard political transitions, which weakened the political positions of (former communist) managers who would have been most interested in insider privatisation.

Primary privatisation created a highly dispersed ownership structure in five of the six countries studied and a less dispersed one in Hungary. A high level of dispersion was the outcome of voucher mass privatisation and/or insider privatisation, and small owners were disproportionately represented. The proportion of small owners was burdensome, too high for the low level of protection of their rights; weak shareholder protection elsewhere used to be coupled with a rather concentrated ownership structure. Furthermore, the high share of non-managerial employees' owner-

ship as a consequence of insider privatisation was not supported by institutions that used to play important roles in Western countries with important employee ownership in their companies. The overly dispersed ownership structure entailed the need for secondary privatisation.

Secondary privatisation was relatively quick if it followed a voucher privatisation that was not mixed with elements of insider privatisation. It was slower after insider or mixed primary privatisation. However, fairly rapid secondary privatisation took place in Poland despite insider (primary) privatisation. This observation leads us back to the character of political transition.

In Russia, Ukraine and Slovenia, where the political transition was soft, primary privatisation was carried out while interpenetration was maintained between public administration and company management. The direct ties connecting companies to government bodies were modified but basically survived. The state became minority co-owner of private legal entities or physical persons in ways that caused uncertainty. Namely in Russia and Ukraine, companies were privatised without the land they stood on, i.e., with the land kept in state property. In Slovenia, a similar uncertainty was generated by a peculiar minority shareholder activism of the public administration based on the combined application of the state's and parastatal funds' minority shareholder positions and the state's role as policy maker, legislator and regulator. Beyond that, the safety of property rights was also compromised by the non-transparent imposition of tax-type payments on companies in these three countries.

The lingering interpenetration between public administration and companies was both bad and good for insider owners' groups. On the one hand, although it left opportunities for them to reinvest company profits in the hope of increased future profits, it made this behaviour irrational, because the insider owners' groups had no guarantee against the confiscation of the potential yields. On the other hand, the interpenetration in question, with the same limited safety of property rights, largely exonerated insider owners' groups, including company managers leading these groups, from the bogey of hostile takeovers. Of course, the deterrence of outside investors, including foreigners, dampened structural changes in the economy and thwarted faster growth.

7.2 Notes on the economic and social consequences of different political and economic reforms

The above title might promise too much; this subsection's goals are actually rather modest.

Starting conditions and political and economic reforms of the first decade of transition from communism towards a democratic, capitalist system together determined the economic and social picture at the turn of the millennium in the six countries studied. When making comparisons, it is important to take into account the differences in starting conditions. What is more, if differences in starting conditions are too large, comparisons may become difficult or even senseless. This may be true of comparisons between Russian and Ukrainian economic and social development on the one hand and the development of the four Central European countries on the other. Another kind of research, with more countries, thus allowing the use of econometric methods, can handle this difficulty (e.g., Falcetti et al. 2000); but the sample of countries in the current study is far too small. Thus, this comparison will be restricted to the three Visegrád countries'—radical reformers'—economic and social performance on the one hand and Slovenia's performance on the other.

Including Russia and Ukraine—like Slovenia, slow reformers—in the comparison would also be problematic because their slow reform path was different in important respects from Slovenia's. Corporative elements of the economic and social system and important efforts aimed at restraining economic and social stratification are Slovenia's characteristic features, distinguishing this country from Russia and Ukraine rather sharply. Strong corporative elements of the Slovenian regime—which are not unrelated to the previous self-management system—are stressed, for example, by Fink-Hafner (1998). Employees' representatives must be on companies' supervisory boards (accounting for half of the members in companies employing more than 2000); besides that, firing employees is severely restricted by legal regulations. Since 1994 the personal income tax has been highly progressive (Stanovnik and Verbič 2005), and economic and social inequalities have also been limited thanks to social expenditures significantly higher than those in other Central European countries (Bohle and Greskovits 2007).

In the final analysis, the slow pace of reforms in Slovenia's case—not Russia's or Ukraine's—is supplemented with socialist characteristics. Thus, restricting this short comparative analysis to the Visegrád countries on the one hand and Slovenia on the other, we compare the results of rela-

tively liberal, radical policies of systemic transformation and relatively socialist policies, aimed at slow progress in reforms. It is important to note that we cannot examine the results of more liberal and more socialist policies only in the field of privatisation: economic and social results are results of policies followed in different fields of the economy and society.

As for the measurement of different countries' performances, performance is the change of different indicators during the first decade of transition. For example, although economic statistics covering very long durations of time are unavailable (mainly because of changing borders), it is known that, for more than a century, per capita national income has been much higher in Slovenia than in the other three and has been higher in the Czech Republic than in the remaining two countries. But our interest is restricted to changes of GDP in (approximately) the first decade of transition. Unfortunately, in some cases only the data of the last few years are available. Then we have to cite them, without the possibility of analysing changes during the period that is the actual subject of our interest.

7.2.1 Visegrád countries and Slovenia: some notes on social development

First let us look at social development, on which, unfortunately, few comparable data are available.

There is no problem with the comparison of human development indexes (HDI) published by the United Nations Development Programme or UNDP, although—compared to their ambitious name—these indexes do not really tell us much.

Table 7.2.1 Human development indexes (HDI) and some related indicators

	Human development indexes			
	In 1990	In 2001	change between 1990–2001	GDP per capita (PPP US\$) rank minus HDI rank in 2001 ^{a)}
Czech R.	0,835	0,861	0,026	7
Poland	0,794	0,841	0,047	17
Hungary	0,803	0,837	0,034	4
Slovenia	0,843	0,881	0,038	3

Source: UNDP [2003]

^{a)} See its explanation in the text

The HDI merges the characteristics of the population's life expectancy and education level with per capita GDP measured at purchasing power parity (UNDP 2003).

Table 7.2.1 demonstrates that Slovenia had the best indexes in both 1990 and 2001. At the same time, its index improved less than Poland's, and only a little more than Hungary's. Of course, the human development index is highly correlated with per capita GDP, and what is interesting for us at this point is its values as compared to countries' GDP levels. UNDP experts developed the rank difference indicator. Countries (in UNDP [2003] 177 of them) are ranked by their GDP per capita values and their HDI, and the difference of the two ranks is calculated for each country. If this—the rank difference indicator—is positive, then the country is more advanced in human development than in GDP growth. According to the data displayed in Table 7.2.2, this was true of all four countries examined here. However, Slovenia had the smallest indicator value, meaning that human development, as defined by the UNDP and corrected for per capita GDP value, was lower in Slovenia than in the three Visegrád countries.

Income inequality is also an important indicator of social development. It can be measured with the “at-risk-of-poverty rates” of Eurostat and Gini-indexes. At-risk-of-poverty rates measure the share of the population with incomes below 60 percent of the national median. Such data on new European Union member states have only been published from 2000 onwards. According to the data, from 2000 to 2002, an average of 11 percent of the population was at risk of poverty in Hungary and Slovenia and 16 percent in Poland. The Czech Republic's only data, for 2001, is 8 percent. This is a dead heat—except for Poland, in which inequalities are clearly higher.

Conclusions that can be drawn from the Gini indexes published in the World Bank's World Development Indicators database are similar. The Czech Republic's and Hungary's indexes were somewhat lower in 1993 than Slovenia's (26.5, 27.9 and 29.2 percent, respectively). They also decreased faster in subsequent years (to 25.4 in the Czech Republic in 1996, to 24.9 percent in Hungary and 28.4 in Slovenia in 1998). The next available figure for Slovenia is 30.9 percent in 2004; Hungary then had 30.1. Poland's index was 32.4 in 1993 and 34.9 in 2005. Czech data for the 2000s have not been published. The other three countries showed a noticeable increase in the Gini index between the 1990s and 2000s; Slovenia is no exception to this rule, as proven by Slovene experts' investiga-

tions.¹ Taking into consideration other former communist countries' data,² Slovenia's performance on this count was better than those of the Baltic countries, but (excluding Poland) it fit the Central European–Western Balkan picture well.

Table 7.2.2 Percentage of the population aged 18–24 with only lower secondary education in 2001–2003

Country	2001	2002	2003
Czech R.	n. a.	5,5	6
Hungary	12,9	12,2	11,8
Poland	7,9	7,6	6,3
Slovenia	7,5	4,8	4,3

Source: Eurostat

Table 7.2.3 Percentage of the population aged 25–64 having completed at least upper secondary education in 1997–2002

Country	1997	1998	1999	2000	2001	2002
Czech R.	n.a.	85,6	86	86,1	86,3	87,9
Hungary	63,2	67,3	73,2	69,4	70	71,4
Poland	76,3	77,8	78,5	79,9	80,2	80,9
Slovenia	69,7	72,5	74	75,3	75,8	77

Source: Eurostat

The population's level of economic activity is an important indicator, both social and economic. According to Eurostat, in 2002, among the four countries in the study, the Czech Republic had the highest activity rate of the working-age population: 70.6 percent. Slovenia's indicator was 67.8 percent, Poland's was lower (64.6 percent) and Hungary's much lower (59.7 percent). From 1997 onwards (comparable data are not available for earlier years), only the Hungarian activity level changed significantly (increasing by 2.1 percentage points). Despite that, Hungary's performance remained far behind those of the others. This was probably at least

¹ Stanovnik and Verbič (2005), summarising other papers' results and also contributing their own calculations, conclude that income inequalities in Slovenia decreased in 1994 (mainly because a highly progressive income tax was introduced that year) but after that year increased gradually.

² The Gini indexes in Estonia, Slovenia and Lithuania were significantly higher than in Slovenia (in 2004, 36.0, 35.7 and 35.8 percent, respectively), but Bulgaria's and Romania's (in 2003, 29.2 and 31.1 percent, respectively) were not higher.

partly related to the relatively high percentage of people with little education in this country. The relevant data are displayed in Tables 7.2.2 and 7.2.3. The share of people with only a lower secondary education is visibly higher, and the share of those who completed at least upper secondary education is lower, in the workforce in Hungary than in the other three countries.

It is not clear how or whether Hungary's disadvantage is related to the particularities of its transition. Köllő (2009) (see also Köllő and Nacsá 2004) found that the Hungarian economy after 1990 has been rather weak in employing people with low levels of education—weak, that is, in comparison with advanced market economies. We do not know of any similar comparison with other former communist countries. But in any case, the salient finding was Hungary's disadvantage vis-à-vis the other three countries, rather than the three more liberal Visegrád countries' disadvantage vis-à-vis the more socialist Slovenia.

7.2.2 Visegrád countries and Slovenia: some notes on economic development

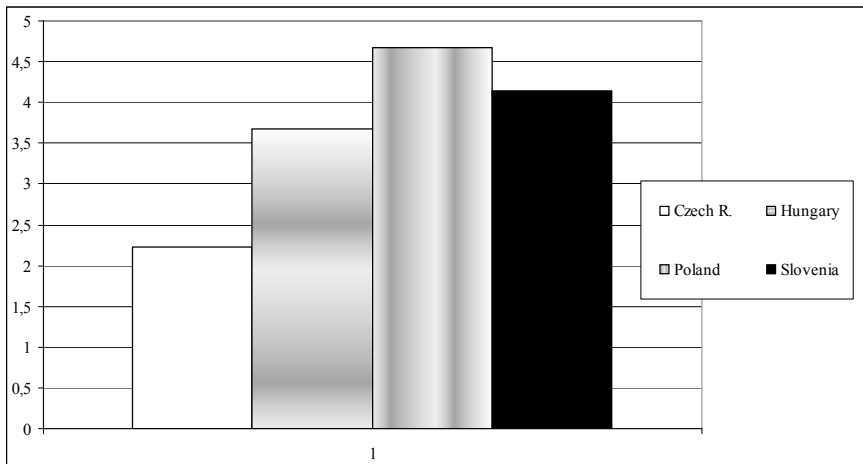
Data for the comparison of economic development are less scarce than data from the social sphere.

A research paper of the Vienna Institute for International Economic Studies (Havlik et al. 2001) analyses in detail the industrial exports and industrial competitiveness of 10 former communist countries (the 10 new member countries of the European Union). Between 1995 and 1999, their exports to (the 15 pre-2004 member states of) the EU increased by 75.8 percent on average; within that, Hungary's and the Czech Republic's exports grew even faster, Poland's by 49.1, Slovenia's only by 25.8 percent. In 1999, 0.83 and 2.65 percent of the EU's total imports of manufactured goods originated from Slovenia and Hungary, respectively. Besides this more than three times difference, the ratio of the sum of GDP of the two countries was only 2.2 (and Slovenia's geographic position is more favourable for increasing trade: it borders Northern Italy, one of Europe's richest regions). From among the 10 countries, only Slovenia exported primarily such manufacturing goods to the EU whose demand grew slower than average. The export prices of the 10 countries were lower in the 1990s, as well as in the previous decade but to a lesser extent, in the EU's market than the average export prices of the same goods. Slovenia had the smallest such price disadvantage in 1995, but then, until 1999, its advantage decreased the least (when Hungary's previously important dis-

advantage already shifted into an advantage, i.e., it already had higher than average prices). Calculations published in Crespo and Fontura (2007) suggest that the structure of Slovenia's exports to the EU changed less between 1995 and 2003 than that of any other new EU member country.

Pezdir (2006) has found that the performance of the manufacturing sectors representing high- and medium-level technology was weak in Slovenia. Their share within manufacturing exports grew between 1993 and 2000 from 16.7 percent to 56.8 percent in Hungary, from 25.6 percent to 36.3 percent in the Czech Republic, but from 25.3 percent to only 29.6 percent in Slovenia. It is worth noting that despite the economic importance of tourism in Slovenia's economy, manufacturing is not a secondary sector. Industry gave 38 percent of the GDP in 2001, less than in the Czech Republic (41 percent) but more than in Poland (37 percent) and Hungary (34 percent). The share of the services sector in the Slovenian economy had been 49 percent in 1990, which, among communist countries, was second only to Croatia. However during the next decade, it increased slowly (to only 58 percent in 2001). This was lower than the corresponding data of several other countries of the region: in Hungary services accounted for 62 percent of the GDP, and in Poland the figure was 59 percent (Matkowski 2004).

Graph 7.2.1 Average annual GDP growth rates between 1993 and 2002, in percent



Source: own calculations on the basis of the World Bank's World Development Indicators database

The indicators of foreign trade and industrial development demonstrate some disadvantages for Slovenia vis-à-vis the three Visegrád countries, but GDP growth, a more general indicator of economic development, is more important. And this shows Slovenia at an advantage. The country's GDP growth rate between 1993 and 2002 was worse than Poland's but better than the Czech Republic's and also somewhat better than Hungary's (see Graph 7.2.1).

It is also important to note that among the four countries, Slovenia's GDP growth fluctuated the least. The relative standard deviation (standard deviation/average value) of the Slovenian (annual) GDP growth rate between 1993 and 2002 was only 0.20; for Hungary, Poland and the Czech Republic, it was 0.39, 0.45 and 0.97, respectively.

The more fluctuating growth in the Visegrád countries can basically be explained by erratic economic policies. The Hungarian deceleration in 1995–1996 was the consequence of the unavoidable austerity measures (named the “Bokros package” after the minister of finance who introduced them) following the increased state budget and balance of payments deficits caused by the populist economic policies of the previous (election) years. The 2001–2002 drop of economic growth in Poland was a basically similar story. Namely, the National Bank of Poland (the central bank) reacted to the increased budget deficit in 2000 (again an election year) by increasing interest rates, and a “war” unfolded between the bank and the government, which continued a policy of high public spending. With inflation not exceeding 4 percent, the bank's base rate approached 20 percent (IMF 2001 and EBRD 2002, p. 182). Such interest rates inevitably dampened economic growth. The Czech recession of 1997–1999 was also caused by the correction of overly loose macroeconomic policies; the microeconomic side of this looseness (the “liberal” regulation of the safety of banks' operation) was discussed in subsection 3.2.

Slovenia, unlike the three Visegrád countries, applied consistent, rigorous macroeconomic policy, and thus it avoided the losses related to decelerations and recessions. Exactly how much growth was lost by the Visegrád countries cannot be determined. What can be said is that their average growth rate between 1993 and 2002 is faster if calculated without each country's above-mentioned “crisis years”.

From this analysis two different kinds of conclusions can be drawn. First, the visible negative economic consequences of Slovenia's obviously rather poor, too-cautious policies of systemic change towards a market-based regime, its policy of consensus-seeking with all interest groups,

were corrected by another policy, a macroeconomic one. The latter policy was sound and can be considered independent of Slovenia's less fortunate policy of slow and slower reforms.

However, another kind of conclusion might be more solid. Namely, there seems to be a positive relationship between the too-cautious (and in itself harmful) policy of systemic transformation and firm macroeconomic policies. Amid a permanent, cautious search for consensus with all actors, which characterised the Slovenian policy of systemic change, governments were not tempted to engage in the irresponsible, populist spending sprees that were observed in the tough reformer Visegrád countries, primarily before elections.³

To summarise: in the period investigated here, the development of manufacturing and foreign trade was weaker in Slovenia, both quantitatively and qualitatively, than in the three Visegrád countries, particularly in the Czech Republic and Poland. General economic (GDP) growth was faster in Slovenia and Hungary than in the Czech Republic, but slower than in Poland. Income inequalities were smaller in Slovenia than in Poland and approximately equalled inequalities in the other two Visegrád countries. In terms of the population's level of economic activity, Hungary's performance lagged behind those of the other three countries, particularly the Czech Republic and Slovenia.

On the basis of all this, the conclusion—which will not surprise economists—may be that the slow, cautious, consensus-seeking pattern of transition chosen by Slovenia was clearly more successful in social development (in terms of moderating income inequalities and increasing the rate of economic activity of the population in working age) and less successful in economic development (in the development of manufacturing and foreign trade and in GDP growth) than the model chosen by Poland, one of the more courageously and rapidly reforming countries. And, based on the details of the comparison above, one can argue that similar differences also separate Slovenia from the other two champions of market-economy-oriented reforms, the Czech Republic and Hungary, but these differences are certainly tiny both in the social and the economic field. If we do not abstract from facts and figures,⁴ we have to say

³ See my paper on the pre-election spending sprees of former communist countries (Soós 2006).

⁴ Bohle and Greskovits (2007) describe the “least market-radical neo-corporative” Slovenian model as the most successful transition in Central-Eastern Europe. The authors do not seem to be familiar with the studies written by Slovenian and foreign authors and

that the jury is still out on which method of transition yields better social and economic results.

cited in the comparison above. They use rather few data, and even so the data often contradict their conclusions. One of their success indicators in the field of industry is the rate of growth of industrial production between 1992 and 2003, which was 1.0 percent in Slovenia, and 3.1 and 6.5 percent in the “loser” Czech Republic and Hungary, respectively. Their other industrial indicator is the share of “complicated” (engineering and chemical) exports in total exports on average in 2000–2004, which was 49 percent in Slovenia and 55 percent and 67 percent in the other two countries, respectively. In the social field, they stress “social protection”, which they measure with the absolute value of social expenditure, finding the highest level in Slovenia but without considering that Slovenia also has the highest per capita GDP.

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This book discusses the policies, practices and outcomes of privatisation in six former communist countries: the Czech Republic, Hungary, Poland, Russia, Slovenia and Ukraine, paying particular attention to differences among countries in these fields and to interrelations between the processes of privatisation and the political transition from communism to a new system.

The analysis is restricted to the privatisation of medium-sized and large enterprises, and only adjunctively deals with the privatisation of banks, non-bank financial companies, natural monopolies and agricultural entities. At the same time, our subject also extends beyond the field usually examined under the title of privatisation or privatisation *stricto sensu*. The latter, of course, means the transfer of the ownership of firms from governmental bodies to private persons or organisations. In this book, this is referred to as primary privatisation. And the analysis will extend to secondary privatisation, here meaning the increasing concentration in ownership structures after primary privatisation.

From the Foreword

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